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FOREWORD

THE importance of the study of Public Finance is well known, but adequate steps to make that study easy and popular are not taken in most countries. In countries with a democratic form of government, the control of the public purse is vested in the hands of the representatives of the people. This enables a growing number of persons in such a country to acquire an intelligent grasp of the financial arrangements and problems of the country. There is, in spite of this, a general impression that problems of public finance are things of mystery and controversy which the layman dreads to think of. The only way to remove this wrong impression is to provide the lay public with simple and easily accessible literature on the subject; which would create both a correct understanding of it and develop an intelligent interest in the same. For this purpose, there should be a simple and lucid exposition both of principles and facts devoid of technicalities and controversies.

Professor K. K. Sharma has, in this book, made a worthy attempt in this direction. He has covered a wide field in a comparatively brief space. He has aimed at a treatment of the subject which will be found useful both to the student and the general reader, who is seeking an introduction to the study of public finance with special reference to the problems of this country. In view of the growing importance of educating the public in India, regarding the way in which they are taxed, and the way in which the money so raised by the State is spent, it is to be expected that works of this kind will make a wide appeal.

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CHAPTER 1

Introductory

THE subject-matter of public finance may be said to be concerned with the manner in which public authorities obtain their income and spend it. In other words, it deals with the income and expenditure of public authorities, and with the manner in which the one is adjusted to the other. The term "public authorities" mainly implies Central or Federal Governments and Provincial or State Governments; but it also includes local authorities such as municipalities, district boards and councils. They differ widely among themselves with regard to the magnitude of the areas, the range of their functions, the objects of their expenditure, the sources of their income, and their financial relations with other public authorities, subordinate or superior to themselves. In a broad survey of the subject, however, these differences are of secondary importance.

The word "finance" relates to money matters and their management, and public expenditure, in its modern sense, implies the existence of a money economy. In modern times, the income and expenditure of public authorities consist mostly of money receipts and money disbursements.

The main divisions in public finance are:—(1) public income, which deals with the manner in which public authorities find money for meeting their expenditure; (2) public expenditure, which has to be incurred by public authorities to discharge their functions and duties; (3) public debts, because if revenue is insufficient to meet expenditure, borrowing is resorted to in order to make both ends meet; and (4) financial administration. The last branch has assumed great importance since the War and it includes the framing of budgets, audit and the financial work of the legislature. The right of controlling expenditure and voting supplies is different in different administrations, but the methods pursued are largely responsible for the efficient or inefficient working of the finances of a country. The legislature must keep an eye over the executive in order to avoid waste and inefficiency.

PUBLIC AND PRIVATE FINANCE

It is useful and instructive to compare private with public finance. It is a common tendency to bring to the study of public finance the same attitude of mind which one brings to bear upon private finance; but it is a mistake to assume an exact parallelism between the two. In some cases public

are almost fundamental distinctions in their respective nature and purpose.

One obvious distinction between private and public finance centres on the relationship to income. The amount that can ordinarily be spent by an individual or a company is limited by the extent of the income available, but governments and local authorities do not rigidly observe this limitation. They decide first what they wish to spend and then proceed to obtain the necessary amount of money. In other words, while an individual adjusts his expenditure to his income, a public authority regards its expenditure as the deciding factor and adjusts its income in response to it. This broad statement is, however, subject to qualifications. To a certain extent an individual adjusts his income to his expenditure for as his responsibilities increase, he will try his best to find new sources to meet them; while similarly, schemes of public expenditure cannot be devised without bearing in mind the capacity of the taxpayers, and consequently in bad times, when its income falls off, a public authority may practise retrenchment as has been done in recent years in different countries. To that extent, therefore, it is not correct to say that the expenditure determines the revenue in the case of public authorities and not *vice versa*.

Public expenditure should also be differentiated from private expenditure in the motive force behind it. Apart from purely personal expenditure, an individual tries to secure a surplus of revenue over expenditure and this anticipated surplus determines whether a particular outlay shall be made. Public departments are not generally inspired by this motive excepting the commercial departments like the post-office, which are intended to be financially self-supporting and possibly profit-making also.

Another difference springs from the liability of public bodies to be influenced by powerful sectional interests in the manner of spending their income. The defence departments may be pressing for expenditure on armaments and air forces in excess of the proposed allowances. This has been the case in all advanced countries of the world since the Great War.

The investment character of some public expenditure is also responsible for the difference between private and public finance. Some forms of outlay are very essential from the standpoint of the community as a whole; but private persons cannot be expected to undertake them, because they cannot give any monetary return for generations to come. Afforestation is a case in point. Such schemes must be financed by the State, because they cannot be expected to yield a revenue for a long time or more.

The distinction between the two kinds of finance resolves

There has been a tendency on the part of the ruling races for conferring an increasing measure of control over their internal and foreign affairs to what formerly were, and to a great extent are, still subject nations. These changes have necessitated the gradual transfer of financial control also along with the development of democratic institutions with or without certain safeguards. Indirectly but in important respects, the financial aspects of these constitutional changes conferring as they do an increasing measure of financial control to the legislature form a part of the study of public finance.

The increase in public expenditure in recent years has coincided with a marked set-back to industrial prosperity. The question is whether the growth of national and local spending has caused the present depression or both of them are due to, and symptoms of, a deeper cause. There are some people who hold that money left in the pockets of the private owners is used to greater advantage than if it has to pass through the public purse. They consider, therefore, that only a ruthless limitation of the spending departments can restore the economic situation. On the other hand, there are others who deny the growth of public expenditure as a cause of our economic difficulties, though they admit that exceptional times have entailed a very large increase in certain types of expenditure.

Questions like these are too wide to be answered in a few words and the problems to which they give rise form an important part of the study of public finance. The common notion that all taxation is a burden should be treated with reserve. Up to a certain point the benefit of the revenue and expenditure to the community is greater than the loss to its taxpayers. The taxes become burdensome only when that point has been reached. The weight of taxation may be so mal-adjusted in some cases that it may fall with undue severity on the producing classes and consequently, it may have very unfavourable repercussions on production. Thus in a discussion of such questions, it is necessary to know the character and composition of the public expenditure and of the nature and methods of the tax system employed. Taxation, therefore, to be seen in its proper perspective, should be examined from all these standpoints, and its effects should be judged over a long period of time in order to strike out a fair balance between the total amount of taxation and the national income as a whole, and also as between the different types of expenditure.

RELATION OF PUBLIC FINANCE WITH ECONOMICS AND STATISTICS

It cannot be too strongly emphasised that public finance is a part of the Economic Science. The subject of public

finance presumes a knowledge of other branches of economic science, specially of the theory of money, credit and banking. As Bastable observes, "an acquaintance with economic science is, it may be said, an indispensable part of the equipment of the student of finance".¹ To take an instance on the point, it may be observed that a knowledge of the laws governing value under competitive and monopolistic conditions is indispensable for a clear comprehension of the incidence and effects of taxation on production and distribution. In a study of public debts with particular reference to the modes of their redemption, a sound knowledge of money, banking, etc., is indispensable. It is thus clear that a study of public finance pre-supposes a knowledge of economic science.

The science of public finance has also an intimate relation with statistics. The ground-work of the subject is largely based on full and accurate statistics. In a discussion of the taxable capacity a comprehensive knowledge of statistics is necessary. In the preparation of budgets and in estimating the distribution of taxation among the various classes in a state, statistical knowledge is indispensable. The "Budget Estimates" in India as well as the "Actuals" and "Revised Estimates" are based on statistical information.

It is largely with the aid of statistics that new financial policies can be pursued in order to suit the economic conditions of a country. Thus the rival claims of direct and indirect taxes in the scheme of an adequate tax system can be carefully weighed and a balance can be struck only with the help of statistical information relating to them. The incidence of customs duties on the manufacturers and consumers can only be determined with the aid of accurate and scientific statistical information. The conflicting considerations of import and excise duties and their effects on home industries pre-suppose an adequate amount of statistical information.

In modern times the tendency has been to raise a larger portion of the tax revenue of a country by direct taxation, because the same falls on the rich. This fact has been proved with the help of statistics. Thus the old and existing theories can be criticised in the light of statistical information that is available. In estimating the yield from the sugar excise duty, for instance, a knowledge of the *per capita* and aggregate consumption of the commodity is necessary, a task which belongs to the sphere of statistics.

The science of public finance like the science of economics is in an advancing stage. Finance is a great policy. Without

¹ *Public Finance* (London, Macmillan & Co.), 3rd Edition, page 10.

sound finance sound government is not possible ; while without sound government sound finance is also not possible. Economic welfare cannot be augmented, and even maintained, without the right type of financial policy, which should make the people more prosperous and leave an adequate purchasing power in their hands to improve trade and industries. The evolution of an adequate type of financial control and administrative machinery is indispensable for enabling the people of various countries to have adequate means of economic welfare. Thus the importance of the study of the science of public finance cannot be over-emphasised both from the theoretical and practical points of view.

CHAPTER II

Public Revenue

THE functions of modern governments are increasing in scope and variety and adequate revenues are required to discharge them successfully and systematically. In order to find out the increasing sums of money necessary for discharging their duties, modern governments have a tendency to tap all possible resources.

A good revenue system should be truly a system securely based on comprehensive statistical information. It should have the characteristics of a good tax system, *i.e.*, the characteristics of equality, certainty, convenience of payment and economy in collection. The subjects of a government should contribute revenue according to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of the State. Further, the amount should be certain and not arbitrary, and it should be collected to suit the convenience of the taxpayers. The collection thereof should also not be very costly.

A good revenue system should also possess elasticity, which is of special importance in times of emergency. It should be capable of increasing automatically with the wealth of its citizens, and with the consequent demands for more expenditure on the part of governments. In India, for instance, the Provinces have not got the elastic sources of revenue under the Act of 1919 and, therefore, they cannot adequately finance comprehensive schemes of universal primary education and of public health.

Finally, there are the characteristics of sufficiency and productivity. The revenue should be sufficient to meet the demands of the public authority. Hence revenue is generally raised from a small number of productive taxes rather than from a large number of unproductive ones. Too much concentration on a few taxes should be avoided and in order that the revenue may be productive, the taxes should be scattered over a large number of commodities. Thus taxes should be spread over a large number of commodities. Productivity is therefore an important quality of a good revenue system.

The income of a public authority may be defined or considered from either a narrow or a broad point of view. In the broad sense, it includes all receipts including receipts from public borrowing and from the sale of public assets, such as war stores. In the narrow sense, it does not include the receipts from these sources but concerns only with those receipts which ordinarily come under the category of revenue.

CLASSIFICATION OF PUBLIC REVENUE

The classification of public revenue has been discussed by many writers at great length ; but much of this discussion is of small practical utility, for the chief purpose of any such classification should be to throw light on the nature of public income. Adam Smith writing on the classification of public revenue remarks, "The revenue which must defray not only the expense of defending the society and of supporting the dignity of the chief magistrate, but all the other necessary expenses of government, for which the constitution of the State has not provided any particular revenue, may be drawn either, first, from some fund which peculiarly belongs to the sovereign or commonwealth, and which is independent of the revenue of the people ; or, secondly, from the revenue of the people. The funds or sources of revenue which may peculiarly belong to the sovereign or commonwealth must consist either in stock or in land Public stock and public lands, therefore, the two sources of revenue which may peculiarly belong to the sovereign or commonwealth, being both improper and insufficient funds for defraying the necessary expense of any great and civilised State ; it remains that this expense must, the greater part of it, be defrayed by taxes of one kind or another ; the people contributing a part of their own private revenue in order to make up a public revenue to the sovereign or commonwealth".¹

Thus he divides public revenues into two classes : (1) property belonging to the sovereign, and (2) revenue derived from the people. This division is not adequately comprehensive. Since Adam Smith's time the scope and functions of local authorities have grown rapidly and social services have also developed very much. The property of the sovereign is now a very insignificant source of annual income (the main source being taxation. Other sources are public undertakings ; public lands ; special assessments ; loans and miscellaneous sources as gifts, fines, etc.)

Taxes are compulsory contributions to public authorities made by the people to meet the general expenses of the State incurred for the public good and without reference to any special benefits in return. All classes of people get protection of life and property from the machinery of government ; and taxes are thus paid in return for such common benefits and the taxpayers do not get any direct and special advantages for these payments. As Prof. Taussig puts it, "the essence of a tax, as distinguished from other charges by government, is

¹ *The Wealth of Nations*, Book V, Chap. II.

the absence of a direct *quid pro quo* between the tax-payer and the public authority".²

✓ *Fees* are payments made by people to public authorities primarily in the public interest for special services which people accept willingly or otherwise. They confer a special advantage on those who pay the fees, though this special advantage is secondary to the primary motive of regulation in the public interest as in the case of registration fees. In this respect they differ from *prices*. Prices are charged by a public authority for specific services and commodities supplied by it, including the prices charged for the use of public property. As a general rule, these prices are paid voluntarily by individuals, who enter into contract with public authorities. Thus the difference between fees and prices is that the former may be compulsory contributions, but the latter are voluntary; while both are for special services.

Fees also differ from taxes inasmuch as they are payments for special benefits enjoyed by the payer; while taxes are for general benefits and not for any direct advantage. It is sometimes very difficult to distinguish clearly between fees and taxes. When, for example, is a licence a fee and not a tax? According to Prof. Seligman, a licence is a fee when the licensee gets a special benefit for the privilege, but where the licence charge is so high as to bring in a net revenue to the public authority, it is a tax.³ On the whole, licence fees may be regarded as taxes; because they are ordinarily far more than the mere cost of service, and the positive or direct service rendered is often absent.

✓ *Special assessments* are sometimes classified with fees; but unlike fees, they are levied especially by municipalities, once for all to meet some extraordinary expenditure, such as a special improvement to property undertaken in the public interest. They are levied on property in proportion to the resultant benefit. According to Prof. Seligman, special assessments possess the following characteristics; "(1) there is the element of special purpose; (2) the special benefit is measurable; (3) these assessments are not progressive but proportional to the benefits received; (4) they are for specific local improvements; and (5) they provide for the capital account to increase, as it were, the permanent plant of the community." A special assessment is a device to secure for the treasury part of the unearned increment in the value of fixed property, which may arise in the neighbourhood of newly opened thoroughfares. It resembles a tax in that it is a compulsory payment, but differs from it in that the payer has received a definite and direct *quid pro quo*. In the latter sense it resembles a price, but

² *Principles of Economics*, Vol. II, p. 483.

³ Seligman, *Essays on Taxation*, p. 411.

differs from it in that the payment is not voluntary and does not arise out of a contract with a public authority.

Under "miscellaneous" fines and gifts are the best examples: Fines like taxes are compulsory contributions levied by public authorities; but unlike taxes their object is not to obtain revenue, but mainly to deter people from certain acts. The revenue should fall if their object is successful, that is, if people are deterred from committing those acts.

Voluntary gifts form, unfortunately, only an infinitesimal part of the income of public authorities. Examples are "conscience money" in the British fiscal system, which is usually only a delayed part payment of taxes, which have already been evaded; and gifts in the form of gilt-edged securities, as when certain citizens handed over War loan for cancellation during the war on patriotic grounds.

In modern financial literature there has been a tendency to lay an unnecessarily great stress on the classification of revenue. The main object of classification is the light which it throws on the nature of public income. The object in view is a practical one. It prevents loose thinking and confusion of thought, and is of help in dealing with matters of fact. No system of classification possesses clear-cut lines of demarcation throughout, and no system is absolutely good or absolutely bad.

Bastable divides public revenue into two classes: (1) "that obtained by the State in its various functions as a great corporation or 'juristic person,' operating under the ordinary conditions that govern individuals or private companies," and (2) "that taken from the revenues of the society by the power of the sovereign".⁴

This classification is not comprehensive, and fees, gifts, fines, special assessments, etc., are difficult to classify under this classification. It has advantages as it is a practical division of the two well-known classes of income. In Bastable's own words, "These are broadly contrasted and must form the basis of any division: it is to their discussion that by much the largest part of any work on the subject must be devoted, and it is by the way in which he handles them that a writer will be judged."⁵

According to Adams there are three main groups of classification with sub-groups.⁶

I. Direct revenue, comprising of:—

- (a) public domains, - *5-5-10*
- (b) public industries,

⁴ Bastable, *Public Finance*, Book II, Chapter I, p. 158.

⁵ Quoted by Findlay Shirras in the *Science of Public Finance*, pp. 115, 116.

⁶ *The Science of Finance*, p. 219 ff.

- (c) gratuities, gifts, etc.,
- (d) confiscations and indemnities.
- II. Derivative revenue, comprising of :—
 - (a) taxes,
 - (b) fees, assessments, fines and penalties ; and
- III. Anticipatory revenue, comprising of :—
 - (a) the sale of bonds or other forms of commercial credit, and
 - (b) treasury notes.

The first group deals with revenue mainly from public lands, and public industries ; while the second group has for its scope taxation, and the third public credit. These classes overlap and cannot be said to be clear-cut.

• Another classification is attempted by Seligman, which is based on the relative importance of the public and private purposes in the service rendered by the public authority. All public revenues are divided by him into three classes as below :—

- I. Gratuitous as gifts ;
- II. Contractual as prices, including public property and industry ;
- III. Compulsory, (a) eminent domain-expropriation ; (b) penal power—fines and penalties ; (c) taxing power, including fees, special assessments and taxes.

This classification depends upon the relative importance of special to common interest. "In the one case the individual is the chief or only factor ; in the other case the individual sinks his own importance in the common welfare of the community, and whatever benefits he derives come to him only incidentally as a result of his membership in the community. At one extreme lie prices, which depend upon the relation of the government to some particular industry or individual ; at the other extreme lie taxes, which depend upon the relation of the government to all industries or individuals ; midway between these extremes lie fees."⁷

The proper classification would be to divide the revenue into (a) tax revenue and (b) non-tax revenue. Tax revenues should include both special assessments and fees. Fees in this respect refer to revenue obtained from monopoly enterprise as registration ; while fees from education and other social services would not come under tax revenue. Fees in the technical sense refer to cases where "there is a special and measurable benefit accruing to the individual together with a predominant public object".

Taxes can be grouped into two main classes, direct taxes and indirect taxes. (*Direct taxes* are defined to indicate those

⁷ Quoted by Findlay Shirras in the *Science of Public Finance*, p. 116.

taxes which are paid once for all by the person from whom they are collected and not passed on to others; while indirect taxes are paid by the producer or importer and passed on to the consumer. For purposes of obtaining revenue it has been found more suitable to levy taxes at the source of income, and the person upon whom the tax is levied is said to bear the impact, whereas the incidence is upon the person who ultimately pays it. Thus when a government is deciding upon its methods of taxation, it should be fairly clear with regard to the ultimate incidence of the system and the ability of the taxpayers to meet the charges. When the impact and the incidence are on the same person, the tax is a direct tax; while if the impact and the incidence are on different persons, the tax is an indirect one.

John Stuart Mill defined a direct tax as "demanded from the very persons who it is intended or desired, should pay it" and an indirect tax as one "demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another".⁸ In this case the intention is that of the legislator, which may not always conform to actual facts. For instance, in the British income-tax under Schedule A the tax on the income of the landlord from the ownership of land and buildings is collected from the occupier of the land although legally imposed upon the landlord. The occupier deducts it from rent, and any contract not to deduct same is void at law. According to the definition of Mill, this tax would be indirect; but in reality it is direct.

The intention of the legislator is not thus sufficient for the distinction between direct and indirect taxes. According to Hadley the distinction between direct and indirect taxation should be based on the immediate and not on the ultimate incidence.⁹ According to him, taxes which are not shifted at all and those which are legally shifted are direct; while those which are shifted quickly through commercial competition among consumers are indirect. According to Bastable "those taxes are direct which are levied on permanent and recurring occasions, while charges on occasional and particular events are placed under the category of indirect taxation".¹⁰ Generally death duties are regarded as direct taxes in the terminology of finance; but if Bastable's definition were accepted, these inheritance taxes would come under the category of indirect taxation.

All things considered, direct taxes should be defined as those levied immediately on the property and income of

⁸ *Principles*, Book V, Chap. III, para 1.

⁹ *Economics*, pp. 459-461 (Putnam's, London).

¹⁰ *Public Finance*, p. 291.

persons and those which are paid by the consumers to the State direct. In this way, income and property taxes and consumption taxes directly paid to the State would come under the category of direct taxes, while other taxes would be grouped as indirect. Thus those taxes which reach the income and property of persons through their acts and enjoyments and also through their consumption of commodities under customs and excise would be indirect. This distinction does not depend upon the intention of the legislator, but the basis is whether the tax is immediately paid from income or property and directly by the consumer. In that case, it is a direct tax; otherwise it would come under the category of indirect taxation.

Most tax systems contain both direct and indirect taxes. The former are generally imposed on income, house property, land and estate passing at death, while the latter are chiefly taxes on commodities, i.e., the customs and excise duties. In each case there are certain advantages and disadvantages as compared with the other form of taxation, and, therefore, attempts are made in practice to utilise both forms so that the disadvantages of one may, to a certain extent, be neutralized by the advantages of the other.

The advantages of direct taxes may be summarised as below :—

1. *Economy* in the cost of collection is secured : because the tax is paid direct to the State by the taxpayer and no wastage is incurred.

2. *Certainty*.—The taxpayer knows what he has to pay ; while the State can estimate the yield with a certain degree of precision, and it can adjust its finances accordingly.

3. *Equity*.—Direct taxes are equitable as they permit of a reasonably just system of progression, and also enable certain adjustments to be made to meet individual circumstances. Their incidence is not difficult to judge, and as a general rule, it may be assumed to be upon the person taxed.

4. *Elasticity*.—The yield from direct taxes increases automatically as wealth and population increase and thus they permit of an adjustment between the income and expenditure of public authorities.

5. *Social effect*.—The social effect of direct taxes is beneficial inasmuch as they develop the civic consciousness of taxpayers, and when the latter feel the taxes, they take an intelligent interest with regard to the disbursements of the revenue.

Their disadvantages are as follows :—

1. *Inconvenience*.—The payment of such taxes in lump sums is not as convenient to the taxpayers as the continuous payment of very small amounts in the case of indirect taxes.

In the compilation of forms and the supplying of returns to the tax collectors, the taxpayers are put to some inconvenience. Further, many people prefer to be taxed "in the dark"; and they are prepared to pay without hesitation a small tax in the selling price of a commodity. On the other hand, few persons like to pay a large sum in income-tax, as their contribution towards the finances of public authorities. In many cases, the demand for direct taxes may fall at inconvenient periods.

2. *Possibility of evasion.*—A direct tax has been called a tax on honesty, and the contribution can only be evaded by fraudulent returns; while in many cases the payment can be altogether evaded.

3. *Inequality.*—It is difficult to frame a just basis of assessment for all classes of people; and though experience and care may remove inequalities, any tax system is to a certain extent likely to be arbitrary.

On striking a balance we find that on the whole direct taxes are advantageous and the objections to them are based more on the methods of application and administration than on matters of fundamental principles. Some of these objections can be gradually removed as experience of the working of these taxes is acquired.

The advantages of indirect taxes are:—

1. They provide a great convenience both to the taxpayer and the State. The taxpayer does not feel the burden as heavily as in the case of direct taxes inasmuch as he makes payment when he purchases the commodity. The State also collects such taxes conveniently in bulk from importers, exporters and producers.

2. *Elasticity* is another advantage of indirect taxes; but much depends upon the nature of the article and its demand. A tax on necessities may be very productive if slightly varied to meet the circumstances; while a tax on luxuries may result in a diminished demand and a falling off in revenue. Thus indirect taxes are elastic when imposed on articles of inelastic demand, and they tend to be inelastic when imposed on articles of elastic demand. They are also elastic inasmuch as their yield usually increases or decreases with the increase and decrease in population. In particular this applies to taxes on necessities.

3. *Difficulty of evasion.*—Such taxes are included in the prices of commodities purchased and, therefore, their payment cannot be avoided.

4. *Equity.*—They are equitable because they demand a contribution even from those with small incomes; while indirect taxes on luxuries exact contribution from those who are best able to bear the burden of such payments.

5. *Social benefit.*—Indirect taxes on drugs and stimulants perform a useful social and economic service by restricting the consumption of articles which are detrimental to efficiency, and at the same time they produce revenue.

In addition to direct and indirect taxes, special assessments and fees, certain other contributions or impositions as tributes, capital levies and indemnities should also be included in tax revenue. Fines and penalties are more correctly included under non-tax revenue than under tax revenue. As compared with taxes, fees and prices, they are of little importance as sources of revenue.

Under non-tax revenue should be included (1) the revenue from government or public undertakings. This would include railways, irrigation and other public works, posts, telegraphs, etc. ; (2) the revenue from social services as education, hospital fees, etc. ; (3) revenue from loans when the state is a lender of money ; and (4) miscellaneous. In India under the last head are included military receipts, exchange and receipts in aid of superannuation.

CHAPTER III

Canons and Distribution of Taxation

THE principles of taxation which were laid down by Adam Smith in his *Wealth of Nations* regarding the characteristics of a good tax system are an indispensable part of any exposition on public finance. The theory of taxation has indeed been considerably extended since the time of Adam Smith, but the fundamental truth of his propositions has not been questioned so far and they form an excellent basis for further enquiry. He succeeded in condensing the principles into such clear and simple canons that none of the later writers has, to any material degree, improved on these principles or succeeded in displacing them from the position which they hold in the science of public finance. Some writers have indeed altered the relative importance of these canons; while others have tried to introduce new fundamental principles, but none has been able to displace them. They may be summarised as below :—

1. *Equality or equity*.—"The subjects of every State ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State. The expense of government to the individuals of a great nation, is like the expense of management to the joint tenants of a great state who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation. Every tax, it must be observed once for all, which falls finally upon one only of the three sorts of revenue above-mentioned, is necessarily unequal, in so far as it does not affect the other two." (Equality in this connection means equality of sacrifice, and not necessarily of the amount paid. In the treatment of taxation, much discussion centres around the best method of ensuring equity or relative sacrifice.)

2. *Certainty*.—"The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put, more or less, in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself..... The certainty of what

each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, . . . , is not near so great an evil as a very small degree of uncertainty."

(A taxpayer should be able to know with certainty and without difficulty how much he will be called upon to pay, so that he may adjust his expenditure accordingly. The State should also be able to estimate with a fair degree of accuracy the yield of a tax, and it should also be able to know with a certain amount of accuracy when the funds derived therefrom will be at its disposal. Certainty implies an absence of arbitrary exaction on the part of the State, and, therefore, an avoidance of economic waste) which is a characteristic feature of an uncertain tax system. The expression "an old tax is no tax" is expressive of the advantages of a tax which is well-known and well-provided for in the monetary calculations of individuals and business corporations.

3. *Convenience of time of payment.*—"Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay; or, when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury, are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them by little and little, as he has occasion to buy the goods. As he is at liberty, too, either to buy, or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconvenience from such taxes." (A convenient tax is justified on the grounds of productivity and good government, and also from the point of view of the taxpayer, particularly when he is poor. The principle of convenience should be kept in view, because it avoids waste of time and of resources involved in the collection and payment of taxes. Indirect taxes usually conform to this requirement, because they are paid in very small amounts in the price paid by the consumer, and are not, therefore, noticed at the time of payment.)

4. *Economy.*—"Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the State. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways. First, the levying of it may require a great number of officers whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose another addition

tax upon the people. Secondly, of the people, and discourage branches of business which employment to great multitudes pay, it may thus diminish the funds which might enable by the forfeitures and fines individuals incur the just tax, it may frequently the the benefit which to individuals the employment of a great number of persons, subjecting them to the nation of unnecessary expense. It will be

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taxation or rated only in parts and all above this sum are taxed proportionally on the surplus, the system is known as *degressive taxation*.

THEORIES OF JUST DISTRIBUTION

There are three theories which have been commonly put forward regarding the just distribution of the money burden of taxation: first, the cost to the public authority of the services rendered to individual taxpayers; second, the benefit to individual taxpayers of such services; and third, individual "ability to pay" taxation.

The cost of service principle can be applied to the supply of postal services, electric light, etc., because the prices of such services can be determined in accordance with this principle. It cannot, however, be applied to services paid for out of the proceeds of taxes as against prices. A tax, by definition, is a compulsory levy, in return for which no direct and specific *quid pro quo* is rendered to the payer. Thus the "cost of service principle" cannot be of practical application.

The "benefit of service principle" fails in the same way. Since the cost of services rendered to individual taxpayers cannot be determined, the benefits for such services cannot also be determined except in a few rare cases such as old age pensions. Under the benefit of service principle, the pensioner would have to return his pension to the Treasury; and if exceptions are to be made, then it is not clear on what principle and to what extent they should be made. Thus we come back to the "ability" or "faculty" theory.

The principle that taxation should be distributed between individuals in accordance with their ability to pay seems to be practical on the face of it. But the question is: what method should be applied to measure faculty or ability to pay? If emphasis is laid on the subjective side, the sacrifice involved in the payment of the taxes will be clear; while on the objective side, the ability or faculty of the taxpayer as measured by his income will come into prominence.

The three most common principles of sacrifice are those of "equal sacrifice," "proportional sacrifice" and "minimum sacrifice". Mill states: "equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person towards the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his."¹ This practical suggestion, however, that a minimum income should be exempt from the tax, while all incomes above this should

¹ *Principles of Political Economy*, Book V, Chap. II.

contribute in proportion, did not go far enough at attaining equality ; although it implied progression in the amount of tax with an increase in income. The principle of progression is, of course, recognised as an important attribute of modern fiscal systems.

Regarding the principle of proportional sacrifice Adam Smith laid down that the subjects of the State should contribute to its support as nearly as possible in proportion to their abilities, and according to him abilities may be measured by the amount of revenue enjoyed under the protection of the State. The general conception of ability to pay may be accepted ; but ability in this respect cannot be judged merely by objective or monetary income. If, for example, one-fifth of all incomes were taken by the State in taxes, a person earning one thousand rupees annually would contribute two hundred rupees ; while a workman earning two hundred rupees annually would contribute forty rupees. It is clear that the sacrifice in the latter case would be much greater than in the former case. Moreover, the ability to pay of a man with a large family is less than that of a man having no dependents but enjoying the same income. Money income alone, therefore, is not the true measure of ability to pay.

MINIMUM SACRIFICE

“Minimum sacrifice, the direct emanation of pure utilitarianism, is the sovereign principle of taxation....Before leaving the principle of minimum sacrifice, let it be observed that, under the limitations which have been described, this principle may also be applied to justify differential taxation on the ground of differences in other respects besides sign of income : for instance, difference in the permanence of the income, differences in civil state, number of children, age and other attributes.”²

Thus if it is assumed that utility decreases in inverse ratio to means and also if it is assumed that the relation between income and economic welfare is the same for all taxpayers, the principle of equal sacrifice leads to ~~proportional~~ proportional taxation, of proportional sacrifice to progressive taxation, and the principle of minimum sacrifice to a relatively high level of exemption and very steeply progressive taxation of incomes not exempt. The principles of equal sacrifice and proportional sacrifice make all members of the State pay something ; but minimum sacrifice does not involve this.

Judged from an objective point of view, the ability to pay can be measured with reference to consumption, property and income. The test of consumption is clearly inapplicable,

² *Economic Journal*, Vol. VII, 1897, p. 556, quoted by Findlay Shirras in *The Science of Public Finance*, p. 164.

because the consumption of the poorer classes is out of proportion to their ability to pay. Property also is not an equitable basis. Firstly, it differs greatly in productiveness; and secondly, people with little property may be earning much, and consequently, their ability to pay may be greater than that of property owners having small incomes.

Income is adopted as the measure of ability in almost all countries, subject to allowances and modifications to meet the different circumstances and responsibilities of the recipients. The modern conception of the faculty theory allows for the exemption of a certain minimum for economic reasons that "taxation which diminishes the general efficiency of labour diminishes the whole faculty of the State" (Nicholson). The wealthier classes have the power to pay more than the poorer classes and thus the system of progression is advocated on this ground also.

THE PROGRESSIVE PRINCIPLE OF TAXATION

The principle of progression achieves the real proportional sacrifice and the idea that was indicated by Mill was that the rate of tax should increase with the amount of income subject to tax. This conception is based on the following assumptions: first, that the utility of income to individuals generally may be regarded as equal; second, that the utility diminishes with each addition to income and that the amount spent on luxuries tends to increase with every subsequent addition to income; and third, that expenditure on necessities is more vital to national efficiency than expenditure on luxuries. The first assumption does not seem to be very much in accordance with facts; while the last two are clearly closer to the truth.

The assumptions, however, provide a working basis for a progressive system, whose main features are, the exemption of a minimum income and the taxation of incomes above the minimum at increasing rates. The main difficulty underlying the progressive principle is the framing of a scheme involving equal sacrifices from all taxpayers. The question centres around the standard with reference to which such relative sacrifices are to be judged. We may accept the view that equal incomes bring equal utility to different persons, but it is difficult to make allowances for the psychological factors involved in the idea of sacrifice and the system of graduation to a certain extent is bound to be arbitrary. Moreover, the system of progression may penalise the property-owning classes, and thus it may prove detrimental to saving and to national production.

THE FINANCIAL PRINCIPLE OF TAXATION

The proportional system of taxation is sometimes considered on financial grounds alone. It is held that the aim

of taxation is to raise money for public expenditure and that, therefore, taxation should not be concerned with principles of equity or ability to pay. The aim of the tax-gatherer should be to obtain the necessary revenue with as little trouble and discontent to the public as possible. Therefore, each person should pay according to his income and the wealthy should pay more than the poor in proportion in which their incomes are greater. This would leave the existing system of distribution undisturbed.

A similar financial principle is sometimes described as the cynical theory of taxation. The maxim of Colbert the well-known French Finance Minister was "Pluck the goose with as little squealing as possible". The principle is based on this maxim, and the upholders of the theory maintain that the main object of taxation is to obtain the necessary revenue with the least possible vexation on the part of the taxpayers. Thus a tax is good if it brings in an adequate net revenue without too much protest from taxpayers generally. This principle is indeed at the root of modern taxation and the great proportion of indirect taxation is attributable to the desire to limit opposition to the least possible extent.

THE SOCIAL PRINCIPLE OF TAXATION

People who are dissatisfied with the existing system of distribution advocate taxation to reduce the glaring inequalities in the distribution of incomes in modern communities. They maintain that the tax system should be so planned and designed as to bring about a better distribution of wealth and to produce revenue at the same time. This object could be attained if the wealthier classes could be taxed more than in proportion to their income. This would discourage production and penalise saving and would also interfere with economic progress. There seems to be little possibility of a very sharp progressive system of taxation ; because the object of reducing inequalities can be, to a certain extent, achieved by a careful application of revenue as to improve the economic condition of the poor. In practice, however, progression does result in taxing the rich to a much greater extent than the poor, and to a certain extent it aims at reducing inequality also.

TAXATION TO REGULATE CONSUMPTION

Taxation is also advocated and adopted in practice to regulate consumption and to reduce the use of alcoholic drugs, which are injurious to health and which reduce efficiency. The aim in such cases is moral rather than economic and financial, and in practice such taxes are very productive of revenue to the taxing authority. They satisfy the canon of economy by providing a revenue and by rendering social service.

PROGRESSION IN TAXATION AND THE NATURE OF INCOME

The principle of progression as noted above is being used to a greater extent with the growth in democracy and with an increase in the scope of the functions of the State as education, public health, social services, etc. Progressive taxation, as a general rule, should be on the amount and not on the kind of income, if it is to be applied on a large scale. The best progressive taxes are income-tax, property taxes and inheritance taxes, and it is these taxes in regard to which the principle of progression is likely to be applied.

Incomes from work should be taxed at a lower rate than incomes from property in order to reduce the sacrifice of the taxpayers to the minimum. Incomes from work are regarded even by those having no socialistic tendency to be on a different footing from unearned incomes of the leisure class. For this reason unearned incomes are taxed at a higher rate than incomes from work. Finance Ministers realise the supreme necessity of raising the largest revenue with the least possible trouble to taxpayers and without making the income-tax an instrument of oppression. Excess profits and conjecture gains are suited for special taxation. In other words, there is a plausible case on grounds of equity for taxes on "windfall wealth". War profits and unearned increment in the value of land are examples of windfall gains. This type of wealth has two characteristics. The first is *undeservedness*, which means that this wealth accrues to its owner without his rendering any equivalent services in return; and the second is *unexpectedness*, that is, the whole of this wealth is not expected by the recipient. The first characteristic justifies the taxation of windfall wealth on grounds of equity; while the second one justifies it on grounds of economy. According to Adam Smith, "Both ground rents and the ordinary rent of land are a species of revenue which the owner in many cases enjoys without any care or attention of his own, though a part of this revenue be taken from him in order to defray the expenses of the State, no discouragement will thereby be given to any sort of industry.....ground rents,....., are altogether owing to the good government of the sovereign, which, by protecting the industry either of the whole people or of the inhabitants of some particular place, enables them to pay so much more than its real value for the ground which they build their houses upon. Nothing can be more reasonable than that a fund which owes its existence to the good government of the State should be taxed peculiarly, or should contribute something more than the greater part of other funds towards the support of that government."³

³ *The Wealth of Nations*, Book V, Chap. II, Part II, Art. I.

DOUBLE TAXATION

Double taxation in the general comity of nations is far more important than has hitherto been imagined. It arises when the place of the origin of the income is one country and it is taken to another country where the recipient resides. The income would then be taxed in both the countries. The importance of this sort of taxation has increased with an increase in the volume of international indebtedness and with an increase in the economic solidarity which binds nations together. For example, the International Shipping Conference of 1921 passed a resolution that "Whilst the shipping industry recognises its obligation to bear its full share of taxation, it is economically impossible for the individual ship-owner to bear that burden in each and all of the countries to which his vessels sail. It is therefore desirable in the interests of international trade that legislation be enacted in every maritime country of the world, giving immunity from taxation in respect to the earnings of foreign shipping in all cases where similar immunity is reciprocally given."

The difficulty of avoiding double taxation arises where the question is asked which governments should forego revenue and to what extent? On the ground that taxes seem to be paid by things rather than by persons, many countries follow the principle of taxing according to origin. The origin is looked on as the main principle, and residence as a purely secondary principle. There is a tendency among governments to be more inclined to give up the principle of residence than the principle of origin, although origin is generally dropped in the case of new investments. For instance, the Dominions of Australia and New Zealand and Brazil have offered their securities yielding fixed rates of interest free from all taxation, present and future.

The League of Nations Committee on Double Taxation submitted certain draft conventions to avoid double taxation and fiscal evasion for adoption by members of the League. In the course of an interview with the Chancellor of the Exchequer, a deputation from the Federation of British Industries was informed that the British Government was prepared to consider any fair and reciprocal arrangement with any foreign country. According to the Finance Act of 1930, the British Government was authorised to enter into reciprocal agreements with any other government to avoid double taxation of the nationals of one country trading in the other.

There are four methods of avoiding double taxation :

- (1) The method of exemption for income going abroad ;
- (2) The method of division of the tax ;

(3) The method of classification and assignment of sources ; and

(4) The method of deduction for income from abroad.

The first one is based on the theory that the borrowing country cannot successfully tax the foreigner, but can only shut him out. In this case, all non-residents are exempted from taxation imposed on income drawn from sources in the country of origin. The advantage is that the inflow of foreign capital increases the economic development of borrowing countries. This principle is recommended in the Report on Double Taxation submitted to the Financial Committee of the League of Nations. The principle that residence and not origin of income should be the controlling consideration in solving the problem could be adopted by countries on a comparative plane of economic equality.

A good deal may be said with regard to the second method of dividing the tax. If countries are reluctant to abandon the principle of origin, the difficulty could be solved by a system of exemption on settled lines. The Royal Commission on Income-tax in 1920 recommended the principle that where income-tax is charged on the same income both in the United Kingdom and in a Dominion or India, the total relief to be given should be equal to the tax at the lower of the two rates (United Kingdom and Dominion or India) imposed.

The third method may be described as below :—

“By convention it might be determined to attach origin taxation specifically and wholly to particular classes of investments or embodiments of wealth, such as rents of land and of houses and mortgages on real property, but to exempt the non-resident in respect of income derived from business securities. The country of residence would allow the whole of the foreign tax as a deduction from its income-tax on the resident in respect of such sources of income, but would charge other sources in full. The country of origin would retain its specific origin taxes in full. It would be necessary to give the country of residence complete power of charging all sources, except for certain specified exemptions, so that the scope of its liability to remit the tax would be easily determined, and the investor, from his total income-tax demands, would be able to deduct certain specified taxes on any real property he might have. It might be desirable to impose some limit upon the power of the country of origin to levy in future specially heavy specific origin taxes, which would unduly deplete the exchequer of the country of origin.” (*League of Nations Report*, 1923.)

The fourth method is opposed to general practice and the whole burden of increased taxation in borrowing countries is placed upon the creditor country.

The ideal of double taxation is to exempt income going abroad. Where it is difficult to adopt, "a plan based on the classification and assignment of sources and modified by the division of the tax would appear to offer the best solution of a very difficult problem.

THE SINGLE TAX

The single tax is the tax on some one class of commodities only in the revenue system of a country. Various types of single taxes have been proposed. The Physiocrats proposed a single tax on the economic rent of land; because it would not be shifted and it would not check saving. This idea, however, involved a false theory of incidence. Henry George made a similar proposal partly on economic and partly on ethical grounds.

The objections to a single tax are :—

(1) It would not produce adequate revenue.

(2) It would mean a very unsatisfactory distribution of the burden of taxation. A millionaire owning no land would escape taxation; while a poor man, who had invested all his savings in the purchase of a house, would pay a proportionately high taxation.

A single tax on income could be devised with advantage. It could yield adequate revenue and avoid unfairness in the distribution of the burden of taxation by means of graduation, differentiation and other devices. There are three grave objections to such a single tax.

Firstly, it would be difficult and expensive to collect, particularly in relation to small incomes.

Secondly, it would secure no special contribution from the inheritors of wealth.

Finally, it would check saving more than other taxes would do.

The first objection could be overcome by administrative improvements and by exempting small incomes altogether; while the second one could be overcome by treating inheritances or gifts as taxable income at the time of acquisition. The third could be overcome by exempting savings from taxable income, and thus imposing a single tax upon personal expenditure in place of personal income. This method will also involve grave practical difficulties and expense and leave loopholes for frauds. An easy way to tax expenditure would be to tax commodities or services direct. But such taxes would necessarily be multiple; while no single tax on one commodity would produce adequate revenue. In case attempts were made to find out such a commodity, heavy taxation would drive it out of use in case substitutes were available for it. In case it were a necessity of life without substitutes,

it would result in a very bad distribution of tax burden and would hit the poor very much.

MULTIPLE TAXATION

A multiple tax system is generally preferable to a single tax system, but too great a multiplicity of taxes would be undesirable. A large number of taxes, however small, would involve a large cost and vexation in collection. It is, therefore, best to rely on a few substantial taxes for the bulk of the revenue. Income and inheritance taxes are the best to tax the rich; while indirect taxes on a few commodities of wide consumption, preferably on commodities not necessary to health and efficiency, should be used to tax the poor.

Another question is whether the characteristic of a good tax is that it should be felt very much or very little. Some people argue that the best tax is that which is least felt and which causes the least inconvenience and conscious sacrifice to the taxpayer. But others think that political responsibility comes when people feel the taxes and that mankind can only learn through suffering. Probably, it is on this ground that many war indemnities are imposed upon the defeated countries if they are responsible for wars. It is also pointed out that if income-tax is imposed upon all, including the poor, all would co-operate in checking wasteful expenditure and the poor would gain in moral stature. It has, however, been generally recognised that taxes which are least felt are the best, and this is a well-known and well-accepted principle in public finance.

CHAPTER IV

Problems of Incidence of Taxation

It is very necessary to distinguish between the incidence and the effects of taxation. The problem of the incidence of a tax is commonly understood as the problem of who pays it. The incidence of a tax is upon those who bear the direct money burden of the tax. The problem of incidence is : who actually bears the money burden of a tax ? In connection with the effects of taxation, the question resolves itself to a discussion of the ultimate economic conditions to which a tax gives rise. In a study of the practical problems of particular taxes, it is sometimes very difficult to separate the problems of the effects from those of the incidence. But to obtain a clear view of the distribution of the money burden of taxation, the distinction has to be made between the two sets of problems.

A distinction must be made between the *direct* and the *indirect burden* of a tax, and also between its *real burden* and its *money burden*. The *total direct money burden* of a tax is equal to the total yield of the tax to the public authorities which impose the tax. There is a corresponding direct money burden or incidence falling upon some to every pie of revenue raised. The payment of a rupee in the form of tax means a greater sacrifice of economic welfare for a poor man than for a rich man. This is a question of the *direct real burden* of the tax and not of its incidence. In case a family is compelled to consume less sugar when there is a rise in its price on account of the imposition of a tax, the family in question has to sacrifice economic welfare. This is a question of the *indirect real burden* of the tax and not of its incidence. When a tax is imposed upon a manufacturer or producer of sugar, some time has to pass before he can shift it on, and in the meantime he incurs a loss of interest on the amount of money given to the tax-gatherer. This is a question of the *indirect money burden* of the tax and not of its incidence.

Thus the incidence of a tax on a commodity collected from the seller may be on the buyer entirely, if there is a rise in its price by the full amount of the tax. The incidence will be wholly on the seller, if the price does not rise at all ; while it will be partly on the seller and partly on the buyer, if there is a rise in the price by less than the amount of the tax.

DIFFUSION THEORY

Sometimes, the view is held that a tax may for some time stick at or near the place where it is originally imposed, but

that it is eventually ~~shifted again~~ and again until it spreads over a large number of the people, whether they may be called upon specifically to contribute to the State or not. This is known as the "diffusion" theory of taxation. This theory assumes that in the long run it does not matter what form a tax may take or what methods are adopted for its collection. It is sure to shift from one person to another, until finally, everybody shares its burden.

This theory is shallow and misleading, the former because it does not consider it useful to trace the incidence of a particular tax and thus avoids the real difficulties; and the second, because it assumes a state of perfect mobility and competition which is far removed from actual, practical conditions. The theory assumes that originally a tax may hit one class of people, but ultimately it must be borne by the people as a whole. It may be said that the incidence of taxes presents some of the most complicated questions in applied economics and cannot be dismissed so summarily as is done under the "diffusion" theory.

We may now make some observations on the direction of shifting, the form which it takes, and the manner in which it is measured. When a tax is placed upon a commodity which enters into trade, it usually moves forward, that is, on to the consumer. The movement is in the forward direction from the seller to the consumer. Whether the whole of the tax is so transferred or only a part is a question which will be examined presently. This depends upon a number of considerations. Firstly, the economic position of the person on whom the impact of the tax falls has some bearing on the question. If the person is engaged in buying and selling the commodity on which the tax is imposed, he will do his best to shift it on to his customers, and failing that, he will try to pass it on to those persons from whom he purchases that commodity. But this backward shifting, though not rare, is yet more difficult to accomplish.

Sometimes, ~~shifting~~ takes place without any outward change in the price of the commodities taxed. The producers may not like to risk friction with the public, and may reduce the quality or size of the commodity concerned. Where the tax is upon the commodities produced by the manufacturer, the shifting is easy, because the consumer is in a better frame of mind to bear the duty as he knows it. The tax may be upon raw materials which enter into the production of the commodity concerned. In this case, it is more hidden, and the producers will try to shift it by reducing the quality or the quantity of their goods, leaving the price as before. Again, the price may rise by the full amount of the tax, but a part of the burden may remain with the seller. Perhaps his sales

may fall at the increased price, and he is prevented from raising the price by more than the amount of the tax owing to the competition of other producers. Further, the price may rise by more than the amount of the tax, because the currency may not be sufficiently divisible to allow of an exact contribution by the consumer; while the seller in charging a round figure will select the upper and not the lower limit in self-interest. For example, if there is a tax of 4*d.* per dozen boxes of matches, the price may rise by $\frac{1}{2}$ *d.* per box if bought separately.

In some cases it is difficult to distinguish the problems of incidence from those of effects. The seller may suffer a reduction in his business or may have to bear a larger interest charge on his capital. This problem is one of effects and not of the incidence of taxation. The tax may be one shilling and the extra charge for interest, etc., may come to one pence. If the price rises by 1*s.* 1*d.* the consumer bears the whole of the tax as well as the extra charges; whereas if it goes up only by one shilling, the whole incidence is upon the buyer; though actually 1*d.* is being contributed by the seller. In case the price goes up by 8*d.*, the incidence is upon the seller to the extent of 4*d.* in addition to the charge of 1*d.* These two charges should be kept separate in tracing and estimating the incidence and effects of taxation.

The movements in prices may coincide with variations in the rate of taxation; but to a certain extent they may be attributable to other factors, and to that extent, may be independent of the imposition of the tax. They may be due to changes in the demand for or the supply of the commodity taxed, or they may be caused by conditions of the currency system of the country concerned or by considerations of exchange, etc. One cannot, therefore, measure the exact incidence of a tax on imported commodities by comparing their prices before and after the imposition of the duty.

Secondly, conditions inherent in the tax also have some bearing upon its incidence, though they may sometimes be ignored. Shifting may be prevented by the design and structure of a tax, quite independently of the nature of the article taxed. A tax may be imposed upon one commodity or upon a whole class of commodities. The demand for some commodities, say, tea and coffee, is competitive or alternative, and a rise in the price of one of them may lead to its replacement or substitution by the other. If a tax is imposed on tea, the seller may not be able to shift it on for fear of the demand being diverted to coffee, which is not taxed. But if both are taxed, the tax can be shifted, though here the amount of the tax and the comparative effects upon prices must be taken into consideration. *It may, therefore, be generalised*

that a tax which is common to all commodities of a certain group is more likely to be shifted than a tax imposed exclusively on a particular commodity in that group.

(The magnitude of a tax is another important consideration in determining its incidence.) A tax of a large amount cannot be wholly borne by the seller, though he may bear a part of it; but where a tax is of small amount, the force of circumstances may be such as to make the burden rest on the seller. There is some amount of trouble and inconvenience to all parties every time when a trader increases his prices, and the resentment of the buyers is great if the duty is not imposed specifically upon the goods offered for sale. The extent of the competitive nature of the conditions of the sale determines the disinclination of individual traders to raise their prices, because the rise in the price will mean a falling off in business. It may be said that if the price were to change only to a slight extent, the aggregate demand might not fall off, and therefore the seller would not hesitate in shifting the tax. But this would be true in case all the sellers acted together even without actually entering into a formal agreement to that effect. But if some of them were to follow a policy of undercutting prices, the producers who would raise their prices must suffer a reduction in their sales.

The shifting of the duty on a commodity is also influenced to a certain extent by its form, i.e. (whether it is specific or *ad valorem*.) In the case of a specific duty, the sellers of the cheapest grades would not be able to bear it as the ratio of tax to profits per unit is altogether excessive. If they are to continue in business, the prices of their goods must rise by the full amount of the tax. In this case, the incidence will be on consumers. If owing to market conditions, prices cannot rise adequately to make up for the duty, the producers of the coarser goods may have to cease production. This will result in a fall in the supply, in an increase in prices and in the transference of the tax to the purchasers. It would be a case of long-run effects rather than of direct shifting, but the outcome is the same from the buyer's point of view. In the case of an *ad valorem* tax the producers of coarser goods have not to bear such a high ratio of duty to profit per unit. If they have to bear the burden themselves, they do not suffer so much as in the case of a specific duty. A specific duty is, therefore, somewhat easier to be shifted than an *ad valorem* duty. In other words, the opportunity of shifting the tax to the buyers is not quite so favourable in the case of the *ad valorem* duty as in that of the specific duty. The duty of both kinds may be shifted; but there are greater chances for the shifting of the specific duty than of the *ad valorem* duty.

(The capacity for progression in the case of income tax has some influence upon its incidence.) In the lowest ranges of income, a proportional income tax is liable to be shifted like a specific duty on commodities. In the case of the proportional income tax, the tax on very low incomes would be shifted backward to the employers or forward to those who buy the products of persons on whom the tax is imposed. Manufacturers making the smallest profit could not pay a proportional duty, based on average profits, but would pass it on either backward or forward or go out of business. But a progressive tax would not be shifted with the same facility even in the lower ranges of income. The marginal producers would not be required to pay at the same rate as those making large profits and would not thus be impelled to raise their prices. Thus in the case of progressive taxation, the likelihood is that the duty may remain where it is first imposed.

(Conditions inherent in the objects of taxation also determine the nature of the money burden or of the incidence.) An income tax is shifted, if at all, in a different manner from a tax imposed upon commodities. The income tax is not intended to be shifted and the payer finds it difficult to transfer the burden. A manufacturer or trader may try to raise the price of his goods, but this is rarely practicable. In case he draws his income as salary, the difficulties are even greater.

Taxes on commodities are usually intended to be shifted. The fact that the articles taxed enter into exchange facilitates shifting; because the machinery for the shifting of the tax is present. Excise and customs duties themselves vary in their capacity of transference according to the relative position of the taxed commodities in the different stages of production. Duties on producers' goods can be more easily shifted than those on consumers' goods. In the former case, there is an opportunity of transfer at every stage when the goods change hands. In the case of consumers' goods, the tax comes to stay there; because the consumer is at the end of the chain of production. He can lighten his burden by shifting the tax backward, which is very difficult.

(In the case of a tax of a recurring nature, the incidence is partly determined by the degree of durability possessed by the commodity.) A person buying the property takes into consideration the question that he will have to pay annual taxes thereon, and the price offered is less than it would be if no such charges were to be borne. The price is the value of the property *minus* the capitalised amount of the tax.

The owner of such property at the time when the tax is first imposed suffers a double loss. His income is reduced by the amount of the tax and the value of his property by the amortised value of the annual taxation. The advocates of the

amortisation theory hold that the incidence of the tax is upon the original owners of the property; because the purchaser buys it free of tax himself. The annual payments that have still to be made to the State are said to be balanced by the interest from the capital sum that is saved when the property is obtained, and, therefore, they do not represent a net charge at all.

(The elasticity of demand) and supply is a more important consideration influencing the incidence of a tax than the nature and form of the tax itself. The demand for luxuries is usually elastic; while that for necessities is comparatively inelastic. Elasticity and inelasticity are not absolute terms, but are relative only. Those who can buy the most costly luxuries will not restrict their purchases, if there is a rise in the price by a moderate amount. Some people buy them merely because they are expensive and in case they were very cheap, they would refrain from purchasing them. But the number of persons, who are just in a position to purchase the article at the original price, and who, after the imposition of the tax, would not purchase it, is perhaps more numerous.

The demand for necessities is not as inelastic as is generally supposed. There are persons who have a surplus after purchasing their necessities. After the rise in price, they would purchase the same quantity as at the original price. But those whose income was barely adequate before would cut down their expenditure on the articles for which their need was least insistent.

Subject to these generalisations it may be said that the demand for luxuries is elastic; while that for necessities is inelastic; and a tax on luxuries is less likely to be shifted than one on necessities. The demand is also rendered more elastic by substitutes; and thus if a substitute is left untaxed or taxed at a lower rate, the demand for the former commodity is likely to be very elastic. In general then a tax on luxuries raises their prices by a smaller amount than a corresponding tax on necessities. A tax on commodities that compete with untaxed commodities is more difficult to be shifted than a tax levied upon the whole range.

The determination of the incidence also depends upon the elasticity of the supply of a commodity. The greater the elasticity of the supply, the greater is the bargaining power of the seller, and the easier it is to shift the burden to the buyer. If a tax is placed on a commodity whose supply can be increased or diminished very quickly, the producer will immediately reduce the output in response to a possible curtailment of the demand therefor. He will then be in a more advantageous position than sellers having fixed stock in his negotiations for prices with purchasers.

The elasticity of supply is influenced by the (mobility or adaptability of the capital goods employed in production.) Machinery and plant may be highly specialised and may be employed only for the original purpose, or they may be used for somewhat different purposes, should occasion require. The latter is the case with machinery intended for making parts of watches, which can be employed in case of necessity for producing delicate parts of other things. If a tax were imposed on goods produced by these two types of machinery, specialised and adaptable, assuming the elasticity of demand for the commodities produced to be the same, the manufacturer of watch parts would be in a better position than the other manufacturer. He can shift the tax more easily than the other one can.

(The comparative mobility of capital is an important factor in determining the incidence of customs duties.) Producers in a certain country may have invested large sums of money in specialised machinery to supply goods to a foreign market. The degree of specialisation will depend upon the extent of the demand. The country importing the goods may impose a tariff. The demand in the importing country may be so elastic that a rise in price by the amount of the duty may reduce sales considerably. Under these circumstances, for a time, the sellers have to bear a portion of the duty themselves. It is only in rare cases that the foreigner can be made to contribute to the exchequer of the home country and this is one of them. The producer cannot use his capital for other purposes, and he may have no alternative market of important size for his goods. Then he will bear a portion of the tax himself.

(An important consideration determining the incidence of import duties is whether the foreign producer is in effective competition with producers in the country levying the duty and in other parts of the world, or whether he enjoys monopoly of the supply of goods in question.) The competition between the different foreign producers, even in the absence of competition from home producers, may be so keen that some of them may themselves bear the duty rather than risk a reduction in their sales. If the foreigner is a monopolist and is charging the maximum prices, then he may not be able to raise the prices of his goods. The amount he pays in duties may thus be less than the loss he would suffer in profit by increasing the prices of the goods.

But such instances of monopoly are rare. Even in the case of exclusive power over production, substitutes may be available, which provide a check upon the price policy of the monopolist. If a customs duty is imposed or increased, the policy of the monopolist may be influenced by the taxation

of the substitutes. If, however, all commodities of this class are taxed at a proportionate scale of duty, without involving any preference or protection, the price may go up by the full amount. The incidence then may entirely fall upon the home consumer. But if the foreign monopolist has to pay a relatively higher duty than his competitors, he may not be able to recoup himself by charging higher prices. Then he may have to contribute something to the exchequer of the home country.

(Another condition determining the incidence of import duties is the comparative importance of the country's market from the producer's point of view.) The country imposing the duty may have a monopoly of the demand of the goods of the foreign country. The foreign seller will then find it difficult to raise the price. But if other markets are available to him, he can sell his goods there, and if the demand of the consumers of the country imposing the duty is very insistent, the latter will have to bear an incidence of the import duty.

Thus the incidence will also depend upon the elasticity of the demand for the foreigner's product. In case of the inelastic demand for those goods, the price would be raised by the amount of the tax without reducing sales, and the incidence will fall upon the consumers. But if the demand, besides being exclusive to the people of the taxing country, is of an elastic nature, the foreign seller may have to bear the whole of the duty himself.

A fourth condition is the extent to which it may be possible to produce the commodity at home. If the article cannot be produced at home, the price will rise as a result of the imposition of the tax, partly because of the tax itself and partly because of the reduced supplies from abroad. In case, however, the demand is very inelastic, there would be no possibility of a reduction in the supplies from abroad. In the past, however, home production might have been restricted, not through natural, physical and climatic conditions, but because of the early start of the foreigner in that industry, so that only the best home firms could carry on production and compete with the foreigner. Under such circumstances, the increased price resulting from the imposition of the duties would afford protection to the industry, and producers who were hitherto below the margin would begin to supply for the home market. The higher the level of the new prices, the greater would be the possibility and inducement for such firms to enter the field and provide for the home market.

(The conditions of varying costs also determine the incidence of import duties.) If the commodity is produced under increasing returns, the larger sales of the home producers may permit of a reduction in prices. This will, however, depend

upon the effectiveness of competition among home producers. If such competition is very keen, prices may go down, the duty remaining at the original level.

(The conditions of joint demand and supply also determine the incidence of taxes.) If conditions permit, a tax on one of such articles may be partly shifted to the consumer or producer of the other commodity that enters into the joint relation. For instance, in the case of the demand for wines and bottles, the wine producer may try to shift the duty to the consumer. If he cannot do that, he will reduce the price of the bottles, and thus a part of the burden of the tax on wines will fall on the makers of bottles. The manufacturer of motor tyres and other rubber goods will similarly try to pass on the duty to the purchasers of motor tyres, but if he cannot do so, he will have to increase the prices of other rubber goods. Under such circumstances, the incidence of a tax on tyres would fall partly on consumers of the other joint products.

He may have already been charging the highest prices consistent with maximum profits for his several products. Then he will have to consider other means of dealing with the problem or may bear the tax himself. Even if he can raise his prices, it may be argued that as he could have charged the same prices before the imposition or increase in the tax, shifting in the real sense of the term has not taken place. The tax may have a considerable effect upon the policy of the seller; but it has not directly entered into price.

(Another factor of great importance is the time element in determining the incidence of taxation.) A tax may be of small amount and the seller may be prepared to bear it himself to avoid friction with his customers. In the long run, however, conditions may be different. The supply may be inelastic in the short period but elastic in the long run. Expensive and specialised machinery may have been employed and production cannot be curtailed immediately. The burden of the tax in the short run will fall upon the manufacturer. In the long run the supply can be adjusted by restricting the investment of new capital. Then the prices can be raised by the full amount of the tax. Thus in the long run, the incidence may fall upon purchasers.

INCIDENCE UNDER COMPETITION

The factor of competition is another important consideration determining the incidence of a tax. Many firms with differences in advantages of production may be producing a commodity. Some of them may be marginal and others superior and there would be grades of superiority from the point of view of the advantages of production. Thus under competition, there may be a number of firms, each with a

different unit cost of production, and each with a varying rate of profit. The selling price of the goods of all may be at the same level. If a tax is imposed, its incidence will vary according as it is imposed upon the commodities or upon the profits of the producers. A tax on the product is likely to be shifted on to the consumers. If it is of a small amount, the superior and the more profitable concerns may decide to bear it themselves, when the marginal firms will go out of business, because the latter cannot reduce their prices. In the case of a great elasticity of demand also, the price may not be reduced for fear of a falling off in sales, with similar consequences to the marginal producers. As a general rule, however, a tax on a commodity is shifted to the consumers and the respective positions of the several firms remain as before.

The incidence of a tax on profits is different. There is minimum tax-free income and the marginal firms will remain unaffected by a tax on profits. If the superior firms increase their prices as a result of a tax on their profits, they stand the risk of losing their customers to the marginal firms whose prices remain unchanged. If the rate of duty goes up in proportion to profits as the case actually is, the difficulty of shifting the tax becomes even greater. Those producers who make very high profits and thus have to pay the highest rate of tax are in fear of being undercut by firms whose profits are taxed at a lower rate. Thus the shifting of taxes on profits under competitive conditions is very difficult.

INCIDENCE UNDER MONOPOLY

Under monopolistic conditions the consumer may not have to bear the whole of the money burden of a tax. Under monopoly, cost and price may not be identical as the monopolist can charge as much above the actual cost as he thinks practicable. The price charged by him is determined by conditions of demand. He cannot charge a high price if the amount demanded is likely to be small at that price. Similarly, he will not charge a very low price if he thinks that the resultant increase in demand would not be sufficient to compensate for the reduced profit. To a certain extent, the price is also determined by reference to the unit costs of production at the different levels of output. Generally, the cost per unit will fall with an increase in the volume of production or output. The monopolist thus fixes the price at a point, which having regard to the conditions of cost and demand, gives him the highest net profit. The monopoly price is generally at a higher level than the competitive price.

A tax may be imposed either on the monopolised commodity or upon the profit of the monopolist. A tax on the commodity may be so small that the monopolist may not

regard it worth his while to raise the price. If it is appreciable, he may decide to increase the price by the full or by the partial amount of the tax, even though his sales are slightly reduced and his unit costs increase. He does not fear the possibility of being undercut by his rivals, because the commodity tax affects all equally. Thus the possibility of shifting is very great.

A tax on the profits of the monopolist would be more difficult to shift. He can raise his prices in this case only if formerly he was charging less than the price which was most advantageous to him. If the price is already at the point of maximum net revenue, he cannot recoup himself by raising it. The incidence of a tax on monopoly profits is thus entirely on the monopolist.

In practice it is not so easy to devise such a tax. All monopolists do not work out their prices as explained above. Some of them fix up the prices by guess work; while others may be charging low prices to avoid potential competition from becoming effective. Their monopoly may be due to efficient organisation and can continue only so long as prices are kept low. The prices of many monopoly products are purely arbitrary, and thus the incidence of a tax cannot be determined with certainty.

Some people would advocate the taxing of a monopolist in order that he may return to the public a part of his monopoly gains. They argue that if it is true that he cannot charge more than he is already doing, his share of taxation may be increased so that he may return to the public some of his monopoly gains. Others hold that a monopolist may restrict production and may cut down the total output after eliminating competition. To combat such an anti-social policy, they advocate that the monopolist should be taxed at a diminishing rate as his output increases. This would let the incidence rest on the monopolist; while it would not be to his advantage to reduce the output and to charge high prices.

It may be said that the above view is not quite correct; because the main object of a monopolist is not to restrict the output and charge prices higher than under competitive conditions. He fixes the prices with reference to profits. If he can get the maximum profit at prices lower than under competitive conditions, he would do so in self-interest; while if he can get the highest net profits by curtailing production and by charging high prices, he would not hesitate in doing so. The latter can take place only under conditions of diminishing returns and not under those of increasing returns. Monopolies under conditions of diminishing returns are very rare; while those under conditions of increasing returns are common. They are due to better organisation, and, therefore, generally it would not be to the advantage of a monopolist to restrict

production and to charge high prices ; though it may be so in particular cases which are, however, rare.

To summarise the factors determining the incidence of taxes, it may be said, first, that price movements following the imposition or increase of a tax do not always indicate the extent to which it may have been shifted. Secondly, the incidence is, to a certain extent, determined by the nature of the tax itself, by its exclusiveness or otherwise, by its magnitude and form. Thirdly, the character of the commodity taxed has some bearing upon the problem. For instance, a tax on consumer's goods falls in a different way from a tax on producer's goods. Fourthly, the elasticity of supply and demand is a factor of great importance in determining the incidence, and the time element is important in this connection. Fifthly, the incidence of import duties need not necessarily fall upon the foreign producer. Finally, the examination of competitive and monopolistic conditions shows that the incidence varies according as the tax is placed upon the commodity or upon the profits of producers. The tax on profits is not easy to move both under competitive and monopolistic conditions ; while that on the products can be shifted with comparative ease.

CHAPTER V

Effects of Taxation

HAVING considered the problems of the incidence of taxation, we may now consider the economic effects of taxes. (They may conveniently be considered under three heads, (1) effects on production, (2) effects on distribution, and (3) other effects.)

(The effects of taxation on production can similarly be classified under three heads, (1) effects on people's ability to work and save, (2) effects on people's desire to work and save, and (3) effects on the distribution of economic resources between different employments and localities.)

A person's ability to work will be reduced by taxation which reduces his efficiency. Thus taxes should not be imposed upon the poor, because that would mean a reduction in their efficiency. This argument applies to taxes on small incomes, including deductions from wages, and to taxes on necessities. It also applies to taxes on commodities whose consumption contributes to efficiency.

Ability to save is reduced by taxes on persons who have any margin of income and who are thus in a position to save. The only taxes which do not reduce the ability to save are those that fall on the poor, because they have no such margin.

There is the further danger that high taxation may react adversely on the payer's will to save and produce. Some people may be discouraged from producing; while others may be encouraged to work harder than before. If a man has accumulated a sufficient amount of money to help him without working, high taxation would reduce his income and penalise further efforts. Another man, having no other source of income, may be encouraged to work harder than before; because thereby he has the opportunity to earn the extra money out of which he can pay his taxes.

The effects of any particular tax upon the desire to work and save depend partly on the nature of the tax and partly on the nature of individual reactions to taxation. A person's reaction to taxation is governed by the elasticity of his demand for income in terms of the efforts and sacrifices which he makes to earn his income. If as a result of increased taxation a given effort or sacrifice produces less income than before, the desire to work or save is strengthened, if the elasticity of his demand for income is small and it is weakened if this elasticity is very large. He will try to work and save more than before in the former case, and less than before in the latter case.

People, who have dependents to maintain or who are saving to secure a certain fixed income at a future date, feel compelled by the pressure of increased taxation to work harder or to save more. People desire not only to be well-off but to be better off socially than their rivals. They are impelled to increase their efforts to save more in order to meet the tax.

Whatever the elasticity of the demand for income of the taxpayer, certain taxes have hardly any tendency to influence the desire to work and save. Taxes on windfalls, *i.e.*, taxes in periods of great economic disturbance or even in periods of rapid economic changes do not effect the desire to work and save, and, at the same time, are very productive of revenue. Inherited wealth is sometimes a windfall to the inheritor, and inheritance taxes may also fall in the same category. A tax on a monopolist which gives him no inducement to alter his output or selling price is another example on the point. A tax on a monopolist, which makes a larger output and a lower selling price more profitable, will increase his desire to work and save, whatever the elasticity of his demand for income may be.

In the majority of cases, however, the effect of various taxes upon the desire to work and save depends upon the elasticity of taxpayers' demand for income. Let us start on the assumption that this elasticity of demand is very large, and then consider the comparative effects of various taxes upon the desire to work and save of the taxpayers.

Taxes on particular commodities will reduce this desire to a very small extent inasmuch as the income derived by the taxpayer from a given effort will have less purchasing power. A general tax on income will reduce the desire to save more than taxes on commodities which fall on expenditure only. Thus some people advocate the exemption of savings from income tax in whole or in part in the interests of production. A sales tax is also proposed to be substituted with the same object in view. The chief objection to the substitution of sales tax for income tax arises from considerations of distribution, and also from those of the cost of collection.

Where an income tax differentiates in favour of earned income, *i.e.*, taxes incomes from work at a lower rate than equal incomes from property, it checks the desire to save to a greater extent and the desire to work to a smaller extent than a tax which, while yielding the same revenue, made no such differentiation. But probably the recipients of income from work have a greater desire to save than recipients of equal incomes from property; because the former have a greater incentive to make provision for the future. In other words, the demand for income is probably less elastic among the former than among the latter. A moderate degree of differentiation

in an income tax does not, therefore, introduce any additional check to the desire to work and save. A very high rate of progressive taxation will certainly check the desire to work and save very sharply, and the sharpness of the check will increase more rapidly than the rate of the tax. Thus though progressive taxation is to be preferred to proportional taxation, and almost always to regressive taxation, it is possible to find instances in which the application of the method involves an economic loss both to the taxpayer and to the community. A business man with a large income may be induced to retire from economic activity sooner than he would do if the rates of taxation were lighter. He may think that as he is advancing in years and is already assured of a comfortable income from investment the net return after paying the heavy duties is not sufficient to compensate him for the hard work. The community is the poorer in case he withdraws from economic activity when he is still capable of useful production.

From the point of view of its effects on production, a tax on inherited wealth has certain advantages over an income tax. If its payment is not insured against beforehand the inheritance tax checks saving to the extent to which an income tax does. As regards its actual payment an inheritance tax will probably be paid by realisation of securities to a greater extent than an income tax will be paid out of money which would otherwise have been saved. As regards the effects of the expectation of having to pay in the future, saving is probably more reduced by the prospect of having to pay income tax each year than by the remoter prospect of one's heirs having to pay inheritance tax at some distant date. But if the payment of an inheritance tax is insured against beforehand the actual payment is made out of money received from an insurance company. In Western countries, the habit of insuring against inheritance taxes is becoming very common. The effects on saving of the annual premium payments would be the same as the effects of the annual payments of income tax. In both cases, saving is only checked inasmuch as the annual payments are made with money which would otherwise have been saved. "If, therefore, an inheritance tax is generally insured against, it seems clear that it checks saving to a smaller extent than an income tax yielding the same revenue."¹

The above arguments apply to an inheritance tax of the ordinary type, assessed on the total property passing at death. It is assumed that such a tax checks the desire of persons, accumulating wealth, to work and save. In the case of a tax of

¹ H. Dalton, *Public Finance*, p. 91.

the type proposed by Professor Rignano, an eminent Italian economist, the desire to work and save would be checked to a much smaller extent, if it would at all be checked. According to this proposal, the tax on inherited fortune should be graduated according to the number of times it changes hands by inheritance. The greater the age of the fortune, the heavier would be the rate of the tax. A differentiation would be made between the wealth of a person which he acquires as a result of his own work and saving and wealth which comes to him by inheritance. On his death, the inherited wealth would be taxed at a higher rate than the earned wealth. This will give him a stronger inducement to work and save in order to provide for his heirs.²

Both income and inheritance taxes differ in respect of their effects upon production from another point of view also. The prospective inheritors of wealth will be less inclined to work and save if the inheritance which they expect is likely to be very substantial. They may even begin to run into debt on the strength of their expectations. By reducing these expectations, an inheritance tax stimulates work and saving on the part of prospective inheritors, and the stimulus will be stronger in proportion to the heaviness of the tax. It may be concluded that an inheritance tax on the Rignano plan would stimulate the productive energies of those affected by it in place of checking them.

We may now consider how taxation may affect production through its effects on the distribution of economic resources between different employments and localities. It is generally held that the diversions of economic resources from their natural channels tend to check production; but in a large number of practical instances this rule does not hold good. It may generally be said that "in the choice of taxes, there is a presumption in favour of those which cause the minimum of diversion of economic resources. But this presumption is frequently overthrown by special arguments applicable to particular taxes."

Taxes which have been defended on the ground that they cause little or no diversion of economic resources are those on windfalls, on the site value of land, on monopolists which offer no inducement to change output or selling price and certain others falling with equal weight upon all users of land. When a person is taxed on the employment of his

² For a fuller discussion of Prof. Rignano's scheme and of inheritance taxes, see Dalton, *Inequality of Incomes*, Part IV, Chaps. IX, X; and also Pigou, *Economics of Welfare*, Part IV, Chaps. II and VII, for a discussion of the comparative effects of income and inheritance taxes upon production. Also see Silverman, *Taxation*, Chaps. VIII and X in connection with the effects of income and inheritance taxes.

resources, he will try to divert them to some other employment free from or taxed at a lower rate of taxation. This diversion will be profitable to him only if the loss of income, apart from taxation due to the change of employment, is less than the gain through the payment of lower taxation. Such diversion is, however, very difficult, because capital and labour become specialised in particular employments. But no such difficulty stands in the way of the diversion of new resources, not yet specialised, to other employments, which, but for the tax would have entered the taxed employment. It is, however, the diversion of new resources, rather than of the existing ones, which is of great importance.

A tax on windfalls gives no inducement for diversion. Similarly, a tax on the site value of land, irrespective of the employment to which the land is put, causes no diversion; because its incidence is wholly upon the land owner. The supply of land is fixed by nature, and no restriction of its supply is consequently possible. A tax on a monopolist, which does not give him any inducement to alter his output or selling price, gives no inducement to diversion. It is because the monopoly still remains more profitable than the employment of resources in open competition.

A tax, falling upon all employments of resources with equal weight, does not give any inducement to diversion, because no diversion would be a source of profit. Some people hold that a general tax on income is non-differential; while others argue that it differentiates against saving and diverts savings to expenditure. The reason is that it taxes income when saved and income subsequently derived from savings. If the latter argument be correct, a perfect non-differential tax would be on expenditure only or an income tax which exempts the income saved. Whether a general income tax causes a diversion from saving to spending depends upon the elasticity of the taxpayer's demand for the future income to be derived from savings. If this elasticity is large, the diversion will take place; if it is small, the diversion will be from spending to saving; while there might be no diversion if this elasticity were of an intermediate size.

Some diversions may be advantageous. A tax on whisky, which diminishes its consumption, increases health and efficiency, and the diversion will increase production. The tax on a commodity whose consumption is disadvantageous also causes a desirable diversion of resources. A tax on land used for particular purposes will cause diversion to other purposes, which may be more beneficial to production. A tax on a monopolist, which induces him to increase his output and reduce his selling price, is likely to cause a beneficial diversion; because the additional resources employed would be more

productive than they would have been under competitive employment.

The case of a protective tariff, a classical example of the deliberate diversion of economic resources from their natural channels, may now be considered. Under certain circumstances a scientifically devised protective tariff may increase production in the long run, by developing certain productive resources faster than would have been the case otherwise. Some writers regard this as a bare theoretical possibility. Dr. H. Dalton in his *Public Finance* observes, "The circumstances, in which such a result is likely, are rare, and can hardly arise in highly developed industrial communities. Further, even when the circumstances are present, the likelihood of a protective tariff being skilfully devised from the point of view of the community as a whole, as distinct from that of powerful organised interests, which ought not to be protected, is slight. Further, List's argument assumes that protection should be temporary, whereas one of the most difficult tasks in practical politics is to get rid of a protective tariff once established. And such a tariff, even if originally justifiable, may inflict far greater loss on productive power, if too long maintained, than would have been incurred if it had never been adopted at all. Sidgwick probably said the last word on this matter, when he remarked that many people seem to suppose that in theory free trade is the best policy, but that in practice free trade will not do much harm and may do some good, whereas the true situation is the exact opposite of this; in theory a case may often be made out for protection, but in practice it is far safer to stick as closely as possible to free trade. The prevalence of high protective tariff in modern world is to be accounted for by the great political power of organised interests, which aided by certain elementary but widespread confusions of thought on the subject of international trade, benefit by protection at the expense of the unorganised general public."³

Diversion may also take place as a result of taxation from one locality to another, and production may decrease in the locality from where the diversion of resources takes place. Local diversions are likely to take place in comparatively small communities, where the pressure of taxation drives people or capital into neighbouring communities, where taxation is less heavy. A tax on the site value of land cannot cause local diversions and it cannot be evaded even by dishonest taxpayers.

To summarise the effects of taxation on production it may be said that heavy taxation must react unfavourably on

³ See pages 100, 101. For a fuller discussion consult also my book *Currency and Commerce*, Chapter XVI.

production. The extent of this check will depend upon the character of the taxes imposed and upon the character of the taxpayers. The check may be caused, first, through the effects of taxation on people's ability to work and save ; second, through its effects on their desire to work and save ; and third, through diversions of economic resources between different employments and localities. The check is most serious and most certain when it is caused as a result of reduced ability to save. Under the second head, much depends on the elasticity of demand of the taxpayers for their income. In this case a check to production is possible. Under the third head, a wise selection and administration of taxes will determine whether production will be checked or stimulated.

The proceeds of taxation may be spent in such wise that economic welfare does not improve or public expenditure raised by taxation may stimulate production. In the former case, it would result in a clear economic loss ; while in the latter, it would be conducive to increased production and economic welfare.

Again, if a tax is levied on a commodity produced under the conditions of increasing returns and subject to a sensitive demand, the price is likely to go up by more than the amount of the tax. The output will be restricted and the unit costs will rise as a result of the tax. The profit per article will also be diminished though the consumer will bear the whole of the duty. Total production will fall as the marginal firms will eventually disappear from the market. Thus the supply may fall even below the new level of demand, and consequently, prices may go up by more than the amount of the tax.

If, however, the newly taxed commodity is produced under conditions of diminishing returns, the smaller demand will be met by a smaller supply at a lower unit cost of production. The producer will make a larger profit per unit, when the price rises by the full amount of the duty, but his total sales will be reduced. In this case, there are two conflicting tendencies. Under competitive conditions, the prices may be somewhat lower than they were previous to the imposition of the tax. The fall would correspond to the saving in unit costs. The producers would like to be compensated for their diminished volume of business by raising prices. On the whole, the chances of the price ultimately settling at a lower level than that previously reached are not very bright.

Thus the imposition of a tax upon a commodity produced under increasing returns is likely to jeopardise the interests of the industry and to damage production. It does not, however, imply that instead a tax may be imposed upon commodities obeying the law of diminishing returns, particularly if they are food-stuffs. In such cases the economy in the costs

of production would be more than compensated by the hardship to which the masses of the people would be subjected.

EFFECTS UPON DISTRIBUTION

Just as in preferring one tax system to another, it should be seen that it has a smaller tendency to check production; similarly, within limits, it should have a tendency to reduce the inequality of incomes. The German economist Wagner was the first to advocate the use of taxation to reduce this inequality, and this view is increasingly adopted in modern practice.

A regressive tax system tends to increase the inequality of incomes, and probably, similar is the effect of a proportional, and even a mildly progressive tax system. On the other hand, a very steeply progressive tax system tends to reduce the inequality and the steeper the progression, the greater is this tendency. In the interests of distribution, therefore, the most sharply progressive system that is practicable might be adopted. A rough approximation to such a system would be to cut down all incomes above a certain amount to that amount, and to leave incomes below that level untaxed. In the interests of production, such a system is highly disadvantageous. The case for a considerable degree of progression may, however, be taken to be firmly established. In such cases, particularly in the case of small communities, the possibility is to drive persons and capital outside their areas to neighbouring places. This danger will not be serious if the area over which the progressive tax system is adopted is very wide, and if the mobility of persons and capital across their boundaries is small.

A poll tax, equal in amount for each taxpayer, would be very simple, and a proportional tax would be very convenient if all incomes were equal. It, however, becomes regressive when incomes are unequal and thus it is unsuitable for modern communities. Generally, taxes on commodities of wide consumption are regressive; because the larger the income of a person the smaller is its proportion spent by him on any one such commodity. Thus taxes on food-stuffs are generally very regressive. An *ad valorem* tax on a commodity is not so regressive as a specific tax; because the former differentiates to a certain extent against consumers of the more costly varieties of the commodities. A proportional tax on individual expenditure and a sales tax are also regressive, the former because the ratio of expenditure to income falls with an increase in income. A tax system, including regressive taxes, can be made progressive by including other taxes which are themselves progressive, and whose influence on the general character of the tax system is stronger.

Income and inheritance taxes and general taxes on property can be made very progressive. An income tax can be made progressive by taxing larger incomes at higher rates than smaller incomes. The Indian income tax is progressive, and there is an additional graduated or super-tax only on larger incomes. An argument for differentiation in favour of income from work is that an income from property will give a larger amount of economic welfare than income from work. There is no corresponding disutility in earning income from property as in regard to income from work. In the latter case personal efforts, sacrifices, etc., are the subjective costs which must be debited against the income. In the interests of proportional sacrifice, therefore, the income from work should be taxed at a lower rate than the income from property.

There is the question of the allowances which should be made for the domestic circumstances of the taxpayer. Under the British income tax law, the incomes of a husband and wife are treated as one taxable income, and then allowances are given in respect of the wife and of children below sixteen. No such allowances for the domestic circumstances of the taxpayer are made in India.

A sales tax cannot make any allowances for the domestic circumstances of the taxpayer. Between taxpayers of equal income, it falls more heavily on those who have the largest number of dependents. It cannot also be conveniently made progressive.

A progressive tax on individual expenditure might be devised by exempting savings from a progressive income tax. But it is difficult to exempt savings from income tax and then to devise a progressive income tax system. The reason is that savings are large in proportion to income. Hence a very steep rate of progression on income would be required to devise a tax which should be progressive on expenditure. Thus it would be very difficult to devise a progressive income tax system in which savings could be completely exempted from tax.

An inheritance tax may be assessed and graduated in various ways. As between different inheritors, it would be progressive, if on death, it is assessed on a progressive scale on the amounts inherited by different individuals. Mill proposed to fix a maximum sum, beyond which no individual could inherit. This only implies a steeply sharp progressive tax system. But complications arise when a person receives inheritances on different occasions. For instance, a person receiving two legacies of Rs. 2,000 each would be less heavily taxed than one receiving a single legacy of Rs. 4,000. Thus from the point of view of distribution, it is desirable to graduate an inheritance tax, not only according to the amounts of

inheritances received, but also according to the amount of wealth possessed by them. This principle has recently been adopted in Italy. In England, the British estate duty is assessed on a different basis. It is assessed on a progressive scale on the total value of the property passing at death, without regard to its distribution among inheritors. The British legacy and succession duties are progressive according to the remoteness of the relationship of the inheritor to the deceased. These principles do not necessarily lead to progression as between inheritors. The British estate duty would fall more heavily upon an estate of £50,000, to be equally divided among five inheritors than upon an estate of £40,000 going to a single inheritor. Thus an inheritance tax can be made progressive by assessing individual inheritances and the wealth of inheritors on a progressive scale. A heavy inheritance tax also reduces the inequality of incomes by stimulating gifts from the old to the young to avoid the tax. This tendency is not, however, so strong as it might be supposed at first sight; because the recipients of such gifts are those who would have inherited a little later. Now that gifts come to them earlier, the tax is successfully avoided and they are richer than they would have been if they had to pay the tax.

A general property tax can be made progressive as between property owners by introducing graduated rates, exemptions and allowances. The annual value of the property is a more satisfactory basis of assessment than its capital value; but a progressive tax in certain cases is better on the capital value than on the income of the property.

The principle of progression can also be introduced in other taxes. A tax on land values can be made progressive on the total value of land owned by individuals, with a minimum of exemption. Some taxes which at first sight appear progressive may not be so. A corporation tax progressing according to the ratio of the profits to the capital of the business is not necessarily progressive on individual incomes obtained from business subject to it. For instance a dividend of 5 per cent. on an investment of £5,000 in one company would be taxed at a lower rate than a dividend of 10 per cent. on an investment of £1,000 in another. It would be still less progressive on individual incomes from property; because incomes from public securities or land would escape it, however large they may be; while even small incomes from business subject to it would be taxed even below the level of income tax exemption.

It is claimed that a protective tariff may also be used to improve distribution by reducing the inequality of incomes. It might do so in two ways. Firstly, the imported commodities competing with home industries, paying comparatively

higher wages, might be taxed. It would divert production and employment from industries with lower wages to these more favoured industries. Secondly, the imported commodities mainly consumed by the rich might be taxed. This would mean the substitution of such other imports, which would be more useful to the majority of the community.

These results are, however, possible only theoretically; but in practice, their attainment would amount to very little; while considerable damage might be done. There are other direct methods referred to above which can be successfully used to improve distribution.

OTHER EFFECTS OF TAXATION

Some other economic effects of taxation may now be considered. The cost of collection should be as low as possible; because a high cost of collection decreases production by involving a waste of labour and materials. The cost of collection is less for a heavy tax than for a light one. Therefore, there should be a small number of fairly heavy taxes on commodities rather than a large number of lighter ones. The cost of collection is generally higher for *ad valorem* than for specific duties, and specially heavy for elaborate duties, which differentiate between commodities from different sources of supply. On this ground, there is a case against the introduction of a large element of discriminatory and preferential duties in the Indian fiscal system. Such elaborations should, therefore, be avoided unless they serve really very good and important purposes.

The cost of collecting an income tax or inheritance tax at a flat rate is the same per taxpayer, whether the tax is high or low. It is, therefore, cheaper to collect a given revenue at a high flat rate from a small number of taxpayers than from a large number at a low rate. In the latter case, there is also the additional cost of collection with regard to exemptions, allowances, graduation, etc. The cheapest way to collect an income tax on wages would be to require employers to deduct the tax; but the introduction of a tax on low wages would be very disadvantageous in other ways. It would damage production by reducing the efficiency of wage earners.

The cost of collection is smaller for income and inheritance taxes on the relatively rich than for commodity taxes, which generally fall on the poor. It is thus better to tax the rich through income and inheritance taxes and the poor through a few commodities of wide consumption. In comparatively thinly populated and industrially backward communities, the cost of collection of income tax may be relatively higher than that of commodity taxes and of customs duties.

It is also necessary to see that the cost of collection is as low as possible from the point of view of taxpayers also.

certain indirect effects. In the case of an external loan, however, the wealth of the debtor country is reduced when interest payments are made to the people of the creditor country. Dead weight debt is not a creation of wealth, but there are indirect advantages of this kind of debt also. Sometimes war debts are necessary to preserve the solidarity of a nation and for protecting the rights and liberties of the people of a country.

A public debt tends to encourage the establishment of banks. Trade follows the flag as well as the bank. A State may have to borrow money in exceptional circumstances and this may be a sort of stimulus to industry when these loans are quickly spent on various objects. It is extravagant to accumulate debts in periods of rising prices, because the interest as well as the principal sum may have to be paid in periods of falling prices when the incomes and the taxpaying capacity of the people are reduced. If governments do not raise loans from savings, and if they do not obtain revenue from taxation, they may create new purchasing power by inflating the currency. Inflation reduces the real income of the individual without giving a claim for repayment and, therefore, it acts like a tax in this respect.

The purpose of the debt should be taken into view in estimating its merits and demerits. The contraction of debts by the State does not mean that the capital is unprofitably invested. It is very advantageous for undeveloped countries to borrow loans to spend same for developmental purposes. This investment of capital increases the national income of the country by improving its trade and industries. It is sometimes said that public debts tend to make more permanent the differences between the interest-receiving and the interest-paying classes, and they are thus open to a social objection. But the differences between the two classes are not really so pronounced as often imagined and the argument is not, therefore, of any real significance.

The question then is : what should be the general principle in the raising of loans ? Taxation should be raised only as much as the nation can bear and abnormal expenditure should, as far as possible, be raised from this source. As compared with a loan, a tax has the advantage of not leaving any charges behind it in the form of repayment of the principal to disturb subsequent budgets. Taxation is preferable to loans if commerce and industry are not prejudicially affected by increased taxation. But there is a limit to an increase in the amount of taxes, and loans are necessary to avoid too rapid an increase in taxation. Some systems of taxation can be more easily adjusted to increasing expenditure than others and an unsatisfactory system of taxation is a very great impediment

in the way of raising adequate revenue through this device. A debt should not be allowed to accumulate to such an extent that it may consume a very large part of the revenue. Hamilton and Ricardo emphasised the great importance of taxation over loans in the finances of a State.

FORMS OF PUBLIC DEBTS

Public debts may be classified in various ways, but the classification cannot be uniform. The various forms into which public debts are usually divided are, however, given below :—

(a) *Voluntary and Involuntary Loans.*—A voluntary loan is a loan which is issued strictly on business principles and the creditor subscribes as much as he likes out of his free will. The advantage of this loan is that the investor pays just as much as he wishes. The advantage of a tax is that it does not involve any repayment and does not necessitate any provision in future budgets. A compulsory or forced loan is one which is to be compulsorily made by the creditors to the public authority issuing the loan. Such a loan lacks the advantages of both voluntary loans and taxes and resort to it is made only when voluntary loans and taxes cannot serve the purpose. Such loans are now rare.

(b) *Internal and External Loans.*—An internal loan is one held by nationals within a country. The payment of interest on an internal loan does not affect the national income and it is merely a redistribution of income. An external debt is one which is floated outside the country in question. It thus means the transfer of wealth from the lending to the borrowing country when the loan is made, and a transfer in the reverse direction when interest payments fall due or when the principal is to be repaid. In the case of external debts a part of the income of the debtor country has to be transferred to the creditor country in payment of interest or principal, which reduces the net income of the debtor country. The burden of an external debt is specially heavy and unbearable when it has been borrowed for unproductive purposes and does not create its own means of repayment or when it is imposed by the authority of a foreign government as the war indemnities. Such loans create economic and political complexities of the first magnitude. The debtor country has to raise revenue by taxation, borrowing or inflation. Taxation has its limits and inflation is specially burdensome for the poorer classes; while further borrowing may not be possible at times, particularly when the debtor country is not financially sound. There are exchange difficulties also which such debts very often produce. The debtor country has to export goods or gold in satisfaction of its obligations to foreigners.

sale. A comparison based on the relative proportions of internal and external debts is also difficult. The conclusion is that no one method should be adopted by itself as a basis of comparison ; but a combination of the various methods would prove useful. Perhaps the most useful are the methods of (1) taking the ratio of national debt to national wealth and income, and (2) the percentage of expenditure on the debt service to total ordinary expenditure.

THE REPAYMENT OF PUBLIC DEBTS

The burden of public debts may be lightened in four ways. One of those methods is to repay them. In this connection the chief decision to be taken is how fast repayment shall proceed. In the case of an external debt, the rate of repayment depends upon the wealth of the debtor community in relation to the amount of the debt. The greater the wealth, and the smaller the debt, the faster should it be paid off, and *vice versa*. The rate at which an internal debt should be repaid depends upon different considerations ; because here repayment involves only a transfer of wealth within the community. In this connection there is a strong case for rapid repayment irrespective of the wealth of the community and of the size of the debt. If the debt is repaid only slowly, the burden of interest payment will decrease slowly and will continue for a long time. Thus the check to beneficial social expenditure and to productivity will continue for a long time. If, on the other hand, the debt is repaid rapidly by special but short-lived taxation, the burden of interest payments will diminish rapidly. The burden of taxation will be heavy while it lasts, but will not last long. The check to productivity and to beneficial public expenditure will, therefore, be greatly reduced in a comparatively short period of time.

A second method of escape from the burden of debts is to repudiate them in full or in part. This is inequitable because it hits hard only one class of property owners ; while it leaves others unaffected. If all contracts involving payments to property owners are repudiated simultaneously, no discrimination is involved ; but this would entail a social revolution the effects of which would be harmful for all classes of people.

There are economic consequences also of a policy of repudiation. The future floatation of loans would become almost impossible as the credit of the repudiating authority would be damaged beyond repair. In the case of external loans, there is a danger of provoking aggressive action against the repudiating public authority on the part of the aggrieved foreign creditors. The methods of aggression may be overt military action, secret support of the enemies of the public authority, trade boycott, campaigns of propaganda, etc.

The same arguments apply, though with a diminished force, to such partial repudiation as a reduction in the rate of interest or the reduction of the burden of debt by currency depreciation through currency inflation. Except as a mere incident in a social revolution, an effective demand for the repudiation of an internal debt is not likely to arise. A movement for the repudiation of an external debt may arise when the debt is a legacy of war and when the debtor community develops a sufficient military strength. The existence of international indebtedness is, therefore, a source of danger to the world's financial stability and to its peace.

A third method of escape from the burden of public debts is conversion, *i.e.*, the reduction of the annual debt burden in the form of interest to a minimum. This is a method pursued by all financially sound countries, which are always on the alert to see whether conversion is possible and the extent to which the rate of interest may be reduced to effect a saving in debt charges. For this purpose the price movements of the securities of various public authorities have to be closely watched.

PRINCIPLES OF CONVERSION

A fundamental principle of conversion is that the financier should keep in close touch with the money market with a view to reduce the annual burden of debt. Secondly, in considering whether the policy of conversion should be followed or not, it is necessary to keep in view the probable course of interest rates, taxation and prices. Large holders like banks, insurance companies, etc., should take into account the probable tendency of interest rates in the long run as well as in the near future. Thirdly, the capital of the debt in making conversions should not be increased except for good reasons. Finally, the conversion should be as simple as possible. A reduction in the rate of interest if accompanied by a guarantee against a further conversion for a certain period will ensure a successful conversion. A variety of loans at varying rates of interest may be consolidated into a single debt of uniform interest. In 1757, greater uniformity was introduced into the system of British public debt, when several classes of debt were consolidated into one loan bearing a uniform rate of 3 per cent. and this operation gave rise to the term "consols".

Capital levy is another method of escaping the burden of public debts. The growth in public debts and the consequently heavy interest charges have made the question of the repayment of War debts an urgent one. Above a certain level of exemption, individuals should be taxed on a progressive scale upon an assessment based upon their net wealth. Wealth in this case is to be interpreted to mean capital rather than income.

Such a debt redemption levy has also been described as anticipated death duties and as one writer phrases it, a law would be passed, "by which every man and woman of a suitable degree of wealth would be deemed to die, and to come to life again next morning as the fortunate heir to his own property on payment of an appropriate ransom."² Relief would be given to trade and industry consequent upon the remission of taxation made possible by the extinction of debt and the cessation of interest. This reduction in taxation in the future would reduce the evil effects of taxation on production and thus it would be possible to devote money to social services to a greater extent.

The case for and against a capital levy has been ably set out by many writers. The British Labour Party proposed to have a special levy on accumulated wealth, the limit of exemption being £5,000. Beyond this exemption, there was to be progressive taxation. Dr. Dalton in his *Capital Levy Explained* deals with the whole subject in a thorough manner; while the treatment of the subject by Prof. Pigou in his *Capital Levy and a Levy on War Wealth* is also masterly. A Select Committee of the House of Commons also in 1920 thoroughly thrashed out the subject and formulated a case for capital levy. The arguments for and against a capital levy may now be set forth in a summary form.

It is argued that it is most unfair that millions of men who fought in the War must work to provide interest on money which the lenders were able to lend in large amounts while the former were fighting. "If it was right that young men should give their lives, it was right that rich men should give their wealth in taxation, instead of being invited to make a profitable investment."³ Another argument in favour of a capital levy is that with a general fall in prices the burden of debt will increase and the holders of Government securities will gain still more at the cost of the general taxpayer. Thus a capital levy is regarded as expedient.

Some writers hold that in order to secure a rapid reduction of the debt, the contributors to such a levy should be encouraged to pay as soon as possible and should be required to pay in full within a reasonably short period of time. The normal period of payment should be extended where payment within the normal period would seriously injure the business of individual contributors. Interest will have to be paid on the sum outstanding at the end of the normal period in such cases. The amount of the future instalments would depend upon the

² Dalton, *Public Finance*, p. 203.

³ *Labour and the War Debt*, p. 5 (The Labour Party, 33 Eccleston Square, London, S.W.1.), quoted by F. Shirras.

wealth of the contributor at the time of assessment and not upon his future activities. Thus the payment of these instalments for a longer period would not check production.

The main objection to a capital levy is its effect on capital and credit. Prof. Findlay Shirras sets out the case against a capital levy in the following words: "Traders use War debt to finance their business, and if the War loan were handed over to Government they would be deprived of this. Thus a capital levy would involve a violent deflation of credit, and in the long run a scaling down of wages and prices. Government securities held by banks in the form of Treasury Bills, etc., would not be available for industry for the simple reason that they would cease to exist. Bank deposits would be reduced, and it would be necessary for banks to curtail their loans. The result of this severe deflation of credit is an equally rapid fall in prices, with loss to industry and dislocation and probably unemployment. The trade of a country is carried on with the capital in the hands of citizens, and the destruction of this capital, if paid in War debt, would certainly lead to a decrease of credit in the hands of the mercantile community. If the levy is paid in other securities these would probably be kept for sale by Government, in which case they would depress the prices of all securities, or their dividends and interest would be devoted to the payment of interest on War debt."⁴

Another adverse effect of a capital levy on an organised money market like the London Money Market would be to prevent the inflow of capital from abroad. This would affect industry and commerce adversely permanently or at least for a long period. Thus it appears to be better to repay debt every year out of a surplus which must be made from income and not from capital. An internal debt is generally spent or invested in the country which increases wages and employment, and thus the interest thereon is not a dead loss to the country.

There are other reasons also why a capital levy should not be introduced and one of them is that it penalises thrift. Those who do not save are not taxed, and at the present time thrift is indispensable to promote prosperity. "The shadow of uncertain levies discourages the accumulation of capital, and industrial expansion is hindered."

It is also pointed out that the cost of collection would be high and perhaps assessment would not be possible except by computing from the income-tax returns. The Committee on Increase of War Wealth pointed out that though the administration of such a tax would involve many difficulties, yet they would not be insurmountable. At present, however, the question of a capital levy or of a levy on War wealth does not arise.

⁴ F. Shirras, *The Science of Public Finance*, pp. 546, 547.

The main argument against a capital levy is that it would imply a violent reduction in values as it would result in currency deflation to a very large extent. Wages and prices would fall, and the borrowing capacity of traders would be reduced considerably owing to the loss of working capital. What is necessary at present is a plentiful and cheap supply of capital. The War debt now being a part of the economic system of a country, it is doubtful whether at the present time the introduction of a capital levy would be advantageous. "It would be a case of burning your house to roast your pig, and it would be far better to reduce greatly the debt by a sinking fund and to exercise the strictest economy." A levy should be kept only for a time of emergency ; but at the present time an easy money market is necessary and a levy is not efficacious in a period of trade depression such as is now prevailing. "The greater productiveness of industry and the greater well-being of the community are the real sinking funds which a wise Government should exert itself to build up and encourage, and this will be best done by giving all that freedom to industry that is consistent with right and justice." The Committee on War Finance appointed by the American Economic Association in 1918 to consider the proposal for a capital levy reported against its introduction. The time for a capital levy was suitable immediately after the War when people had made fat profits ; but that opportunity was allowed to slip and now probably the discussion of a capital levy is only of academic and not of practical importance.

BOOK II
INDIAN FINANCE

CHAPTER IX

The System of Public Finance in India

(ECONOMIC and social conditions in every country control the structure of public finance in a great measure and the prominent features of the Indian situation which influence and explain the general financial system of British India may be assembled before attempting a more detailed description. The predominantly rural character of the country ; the vast importance of the agricultural industry ; the low standard of living of the masses, and their poverty ; and the long tradition of centralised administration have deeply affected the nature of the fiscal arrangements in India.

Though India is recognised by the League of Nations to be one of the eight principal industrial countries of the world, more than 70 per cent. of her population still depends on agriculture. The exports consist mostly of agricultural produce ; while the bulk of the imports consists of manufactured goods. The isolation of Indian villages is being modified by motor transport ; “but motor traffic from Indian villages is still confined to passengers, and there has been as yet no marked extension of mechanical transport of goods. Thus, the Indian village is still, to a large extent, economically self-sufficient, and normally consumes what is grown in its own vicinity.”¹

The monsoon has a great influence upon the Indian budget, because in spite of the security against the vagaries of nature in the form of the organisation of the famine relief operations, the extension of irrigation arrangements and of railways, the growth of industries, the mobility of labour, etc., more than four-fifths of the cultivated area of the country depends upon a precarious rainfall. When the monsoon is about to break, its arrival continues to be a matter of deep concern not only to the cultivator and administrator, but also to the finance member.

All this has a great influence upon the methods and calculation of public finance. The central and provincial budgets are adversely affected by an unfavourable monsoon. This means a great deal of expenditure on famine relief works and involves suspensions and remissions of land revenue. It also implies a fall in the internal and foreign trade and a reduction in the railway earnings and the profits of commerce. The loss of revenue continues in the subsequent year also. For

¹ *Report of the Indian Statutory Commission*, Vol. I, Part V, Chapter I, page 332.

this reason, the Indian budget estimates have been described as "gambling in rain," and though the risk has been redistributed by the prevailing arrangements, the uncertainty of the monsoon is still a serious and disturbing factor in budgetary calculations.

The standard of living of the masses is very low and poor as shown by the estimates of the annual *per capita* income for British India given below :—

Year	Annual <i>per capita</i> income
1901-02	Rs. 30
1920-21	„ 107
1921-22	„ 116 and Rs. 74 for India as a whole.

Thus "even if the most optimistic of the above estimates is adopted, the result is that the average income of India per head in 1922 was equivalent, at the prevailing rate of exchange, to less than £8, while the corresponding figure for Great Britain was £95. The contrast remains startling, even after allowing for the difference between the range of needs to be satisfied."

There is a great disparity in the incomes of different classes of people and also in the distribution of taxation. A cultivator pays a substantial portion of his income from land to the State and bears the burden of the indirect taxation while the land holder in permanently settled areas "may pay to the State a merely nominal charge fixed over a century ago and declared to be unalterable for ever, while his agricultural income is totally exempt from income-tax". There is also an absence of death duties in India. Thus the predominance of agriculture and the poverty of the masses explain why Indian revenues are largely derived from land and from taxes on consumption. The scope of internal excises has been limited to a few articles as salt, kerosene oil, etc., on account of the self-sufficiency of the Indian villages; while income tax has not been as important a source of revenue as in the industrialised countries of the West.

The system of Indian public finance has also been affected by the tradition of centralisation of administration. From very early times it has seemed natural that the prevailing financial system should be imposed by the decrees of a distant authority and applied in every district under the orders of the Central Government. Thus the Indian villager has been accustomed to look to the State for help and it is by the orders of Government that he has been accustomed to pay his contributions. There has been a devolution of power to local bodies, but an adequate system of local finance has not yet been evolved. The local authorities are disposed to look for help to the Government. In British India, local rates of all kinds,

urban as well as rural, produced in 1927-28 £12½ millions, which means a little more than the income from rates in that year of the London County Council alone.

INDIAN FISCAL SYSTEM BEFORE THE REFORMS

In the pre-Moghul times, land revenue was collected in grain. Later on, this system gave place to payments in cash and the assessment began to be fixed for a number of years. The most notable reforms are associated with the name of Raja Todar Mal, the Finance Minister of Emperor Akbar. "In the revenue system established by him, we can discern in faint outline many of the distinguishing characteristics of the more scientific methods elaborated under British rule, two centuries later. Akbar had the land carefully measured and classified according to the fertility of the soil, and introduced a system of decennial settlements, the assessment being fixed at one-third of the normal produce commuted into money." A chaotic state of affairs came into existence when the Moghul Empire was in decay. This system of revenue administration has been described as a "disorganised scramble for the greatest amount of income which would be wrung from the land".²

GENESIS OF PERMANENT SETTLEMENT

This was the condition when the East India Company assumed the *Diwani* of Bengal in 1765. Land revenue was the main source of the income of the State. It was collected by the zemindars who intervened between the Government and the cultivators. In 1793 Lord Cornwallis recommended that the land revenue to be paid by the zemindars to the State should be fixed permanently, the amount to be determined on the basis of the actual collections of previous years. The Permanent Settlement Regulation I of 1793 was enacted under which the zemindars were made full proprietors of the areas over which their revenue collection extended, subject to the payment of land revenue. Their lands were liable to be sold for failure of payment of land revenue. The assessment was also declared to be unalterable for ever. It was 10/11ths of what the zemindar received from the ryot by way of rent, the remaining 1/11th being retained as the return for his trouble and responsibility. The assessments were based on inadequate data and in the early years the system did not work well. The result was sub-infeudation under which the zemindars shared the land revenue burden by subletting the land.

The low cost of collection and the punctuality of payment of land revenue were the features of the system which appealed to the business instincts of the Company. Further experiments

² *Imperial Gazetteer*, Vol. IV, p. 206, quoted in the *Report of the Indian Statutory Commission*, Vol. I, page 338.

in this direction in Madras met failures. Meanwhile Sir Thomas Munro had introduced in certain parts of Madras a system of direct settlements with the cultivators themselves. This system, introduced in the greater portion of the Madras Presidency, Bombay Presidency and Burma, is commonly known as the ryotwari system. Its distinctive feature is that the Government deals direct with the cultivator or the ryot and the subletting of land is not prevented. The settlement is periodically revised.

In Oudh, there were petty rulers who had been allowed to contract for a sum of revenue and were called Taluqdars. Over the rest of the province, there were bodies of villagers claiming descent from some common ancestor and they were in possession of the village area. The British merely recognised the proprietary rights of these individuals and bodies and made them jointly and severally liable for the payment of land revenue. In the Central Provinces, under the Mahratta administration which preceded the British, the revenues of the villages had been farmed out to individuals, who in course of time had acquired a quasi-proprietary position. They were made responsible for payment of land revenue. The Indian land revenue system is thus largely an inheritance from pre-British rulers and this factor explains its development on divergent lines in different provinces.

Other pre-British sources of revenue acquired by the East India Company in 1765 were royalties on salt, customs and internal transit duties. The latter were abolished in 1842, but the former two continued to expand. Land revenue at the time of the Mutiny was by far the most important source of income, yielding about two-thirds of the total revenue of the country, while salt and opium contributed over a fourth.

When the control was transferred to the Crown in 1858, the Governor-General-in-Council retained complete control over the provincial expenditure and revenues. Provincial governments remained entirely dependent on annual allotments by the Central Government for the maintenance of their administration and even the most trivial expenditure required the sanction of the Government of India. The financial history of the next sixty years is very largely a history of the growth of the financial authority of the provincial governments. An important feature of this financial devolution was the development of a system of allocation known as "Provincial Financial Settlements". The main stages of this devolution are given below :—

MR. WILSON'S REFORMS

In 1859–60 the military charges absorbed over 50 per cent. of the total Indian revenues and the burden of debt had grown

very heavy. Budget deficits had become the rule and when Mr. James Wilson became the Finance Minister of India in 1859, his first task was to restore the financial equilibrium. He made drastic reductions in the military and civil expenditure, reformed the customs tariff and introduced the income-tax for the first time in the Indian financial system. He also created a State paper currency and established a new system of accounts and audit board. The control of the Central Government over the provincial income and expenditure was, however, retained.

DECENTRALISATION

In 1870, the first important step towards financial devolution was undertaken in India. The administration of certain departments was transferred to the provincial governments, which were given a fixed grant for this purpose, in addition to the departmental receipts. The provincial departments including education, police and medical services yielded little revenue and provided no inducement to the provincial governments to develop their own resources.

In 1877 a further step was taken under the Viceroyalty of Lord Lytton. Important heads of revenue, such as stamp duties, alcoholic excises and income tax collected in the provinces, were provincialised and the responsibility of provinces regarding expenditure was further extended. Fixed grants continued still in most of the provinces.

The system of divided heads of revenue was evolved from 1882. The problem was to provide funds for the Central Government and for the provincial governments, which were subordinate to the central authority, but nonetheless had some expenditure to meet. The method adopted is described below :—

“To meet its own expenditure, the Government of India retains, in the first place, the entire profits of the commercial departments and, secondly, all the revenues whose locale is no guide to its true incidence, such as the net receipts from customs, salt and opium. The income derived from these sources is, however, insufficient to cover the cost of the imperial services, and an arrangement had therefore to be made by which the other sources of revenue should be distributed between the Central and the various provincial governments.”

The provincial heads regarding expenditure in the previous years were ascertained and adequate revenues were assigned for this purpose. This system of doles made those provinces better off which exercised the greatest pressure upon the headquarters and there was no incentive to economy.

The functions of the provincial governments gradually increased and financial settlements with them began to assume

a quasi-permanent character. Up to 1921, however, recurring and non-recurring special grants remained an important feature of the system. They were utilised for stimulating and controlling the development of provincial services, *e.g.*, education and sanitation.

FINANCIAL DEVOLUTION UNDER THE REFORMS

The authors of the Montagu-Chelmsford Report, which is the most important landmark in the history of financial devolution in India, wrote :—

“The existing financial relations between the Central and provincial governments must be changed if the popular principle in government is to have fair play in the provinces. The present settlements by which the Indian and provincial governments share the proceeds of certain heads of revenues are based primarily on the estimated needs of the provinces, and the Government of India disposes of the surplus. This system necessarily involves control and interference by the Indian Government in provincial matters. An arrangement, which has on the whole worked successfully between two official governments, would be quite impossible between a popular and an official government. Our first aim has, therefore, been to find some means of entirely separating the resources of the Central and provincial governments.”³

The object was to estimate the expenditure for central services and to find resources to meet same. All other revenues were to be given over to the provincial governments, which should be made wholly responsible for provincial services. A complete separation was in theory regarded as desirable and the difference of opinion related to the question of carrying it out into practice. The divided heads were recommended to be abolished, and subjects were divided into “central” and “provincial”. Customs, non-alcoholic excise including salt, income tax, general stamp duties, receipts from railways, posts and telegraphs were to be assigned to the Central Government. Land revenue, irrigation, alcoholic excise, forests, court fee stamps, registration fees, etc., were to be entirely provincial sources of revenue.

This would mean a deficit in the Central budget and as a transitional measure the system of provincial contributions was recommended. Such contributions were to be a definite proportion of the estimated provincial surplus, *i.e.*, of the difference between the estimated gross revenue of each province, under the new scheme of distribution, and that province's estimated normal expenditure. Certain subjects of taxation were to be reserved for the provinces, but the

³ *Montagu-Chelmsford Report*, para. 200.

residuary powers of taxation were to be retained in the hands of the Central Government.

THE MESTON COMMITTEE

The Meston Committee was appointed to devise a scheme of provincial contributions and it endorsed the conclusions of the Montagu-Chelmsford Report and advised against a division of income-tax proceeds. The initial contributions were recommended to be assessed on the "increased spending power" of each province resulting from the new scheme of distribution, i.e., the additional income which each province would get on the separation of the sources of revenue. These contributions were to be reduced or increased over a period of seven years so as to conform to certain standard proportions based on the relative taxable capacity of the provinces.

The Joint Select Committee accepted the scheme of initial contributions and considered that the ideal proportions should be reached not by a process of redistribution, but by a gradual reduction of the aggregate contribution. The aim should be the abolition of these contributions and not a perpetuation of standard contributions.

The Devolution Rules govern the distribution of the sources of revenue between the centre and the provinces and the provincial revenues consist of the following :—

"(1) Receipts accruing in respect of provincial subjects (which include irrigation, land revenue, forests, excise on alcoholic liquors and narcotics, stamps and minerals).

"(2) A share in the growth of revenue derived from income-tax collected in the provinces, so far as that growth is attributable to an increase in the amount of income assessed.

"(3) The proceeds of any taxes which may be lawfully imposed for provincial purposes."

The central sources include customs, income-tax, salt, posts and telegraphs, railways and opium. They also include an item reserving to the Central Government all matters not included among provincial subjects.

The Devolution Rules also provided for the payment of provincial contributions to the Central Government. These contributions varied in amount from 348 lakhs of rupees in the case of Madras, 240 lakhs in the case of the U. P., and 175 lakhs in the case of the Punjab, to 63 lakhs from Bengal, 56 lakhs from Bombay, 22 lakhs from the C. P. and 15 from Assam. There was no contribution from Bihar and Orissa. Under emergencies the Government of India with the previous sanction of the Secretary of State could raise the contribution of any province.

JOINT vs. SEPARATE PURSE

The Joint Report provided that the provincial budget was to be framed by the Executive Government as a whole. The provincial contribution was to be the first charge on the provincial revenues and the supply for reserved subjects came next. The Ministers were to allocate the supply for the transferred subjects, and in collaboration with the Governor, were also to decide the imposition of new taxes.

The Government did not accept this method and prepared the division of provincial resources, but the Joint Select Committee did not endorse the suggestion of the Government. It recommended that the Governor should allocate a definite proportion of the revenue to the two sides, unless agreement could be reached between them without his intervention. The Act embodied this scheme and in each Governor's province the two sides confer on this matter and try to reach an agreement on the amounts of the estimates to be put forward by the different departments. The finance department collates the various demands and the Governor promotes the spirit of adjustment. The Governor in no province has had to resort to this power of allocating the available funds in a proper manner; and the two sides of Government have reached agreements without his intervention.

FISCAL DEVELOPMENT SINCE THE REFORMS

The provinces were expected to have substantial initial surpluses with which the nation-building services could be developed. Circumstances, however, made their realisation impossible. The construction work suspended in the War had to be resumed after its termination and the currency fluctuations impeded industrial and commercial development which seriously disturbed the financial situation. The following table brings out the consequences of the adverse circumstances :—

(In Lakhs of Rupees)

Estimates by Meston Committee of increased spending power gained by the provinces under its scheme			Actual surplus (+) or deficit (—) in 1921-22
Madras	..	+ 228	— 99
Bombay	..	+ 37	— 191
Bengal	..	+ 41	— 215
U. P.	..	+ 157	— 148
Punjab	..	+ 114	— 171
Burma	..	+ 182	+ 14
Bihar and Orissa	..	+ 51	— 15
C. P.	..	+ 30	— 24
Assam	..	+ 27	— 24

The consequence was that financial equilibrium had to be established by retrenchment and in place of there being any marked development of nation-building services, expenditure on the transferred departments at the end of 1923-24 was less than in the year 1921-22 as shown by the following figures :—

EXPENDITURE ON TRANSFERRED DEPARTMENTS

(In Lakhs of Rupees)

		1921-22	1923-24
Madras	..	428	418
Bombay	..	561	478
Bengal	..	352	321
U. P.	..	352	314
Punjab	..	307	282

There was a great agitation against the Meston Settlement and the provinces were very much against the scheme of contributions. The Muddiman Committee observed in this connection as follows :—

“It is due to it (*i.e.*, the Meston Settlement) that Ministers have been unable to enter upon a policy of progressive development in the spheres of administration committed to their care. If they had been able to do so, they would have been able to provide an answer to those critics who have reiterated the allegation that the reforms were a sham, and they would also have been able to consolidate their position or else have been required to make way for other ministers who could have enunciated a policy more acceptable to the Councils which would incidentally have assisted in the establishment of the responsibility of the ministers to the Councils.”

CENTRAL FINANCE

The situation regarding central finance was equally embarrassing. For three successive years before the introduction of the Reforms, there were budget deficits aggregating over Rs. 55 crores. The military expenditure in 1921-22 stood at Rs. 71 crores being slightly more than the entire net revenue of the Government excluding the provincial contributions. In the first Reforms budget, additional taxation mostly under customs had to be imposed. Later on, the income-tax and super-tax rates were increased and duties on sugar, machinery, watches, etc., had to be increased. Still the budget could not be balanced. The result was the appointment of the Inchcape Committee which recommended retrenchment to the extent of Rs. 19 crores in the Central expenditure. There was gradually an improvement in the situation with the result that the cotton excise duty was abolished in 1923 and the provincial contributions in 1928.

FISCAL CONVENTION

The Joint-Select Committee had recommended that in the case of agreement between the Government and the legislature in India, the Secretary of State should not intervene in matters of purely Indian interests. This is clear by the extract from the report of the Committee which runs as below :—

“Whatever be the right fiscal policy for India, for the needs of her consumers as well as for her manufacturers, it is quite clear that she should have the same liberty to consider her interests as Great Britain, Australia, New Zealand, Canada and South Africa. In the opinion of the Committee, therefore, the Secretary of State should, as far as possible, avoid interference on this subject when the Government of India and its legislature are in agreement and they think that his intervention, when it does take place, should be limited to, safeguarding the international obligations of the Empire or any fiscal arrangements within the Empire to which His Majesty's Government is a party.”

This principle was accepted by the Secretary of State as is evident from the following words used by Mr. Montagu on 3rd March, 1921, in reply to a deputation from Lancashire in connection with import duties on cotton in India. He said :—

“After the Report by an authoritative Committee of both Houses and Lord Curzon's promise in the House of Lords, it was absolutely impossible for me to interfere with the right which I believe was wisely given and which I am determined to maintain—to give to the Government of India the right to consider the interests of India first, just as we, without any complaints from any other parts of the Empire, and the other parts of the Empire without any complaint from us, have always chosen the tariff arrangements which they think best fitted for their needs, thinking of their own citizens first.”

As a result of the establishment of the fiscal convention, the Indian Fiscal Commission was appointed which endorsed a policy of discriminate protection for the country and declared itself to be against any general system of imperial preference, but pointed out “that the possibility of preferential duties on a limited number of commodities should be considered by the Indian Legislature after a preliminary examination by the Tariff Board.”

After a heated debate in the Assembly the Government's resolution to the effect “that India's fiscal policy should be legitimately directed towards fostering the development of her industries” was passed. A Tariff Board was appointed and since then it has been dealing with claims put forward by various industries from time to time.

CHAPTER X

Layton's Report

THE total annual income of the British people is estimated at £4,400 millions or £100 per head, whereas the corresponding figure for *per capita* income in India is £8 per annum. The proportion of this annual income spent upon military and naval defence is £2 10s. per head or about $2\frac{1}{2}$ per cent.; while the corresponding figure for British India is 3s. 4d. per head or about 2 per cent. of the average annual income. The figures for expenditure upon education in England and India respectively are £2 15s. and 9d. per head.

The chief features of the Indian financial situation in the light of the above information are:—

“The mass of the people are extremely poor.

“She is incurring expenditure on the primary functions of government, such as defence and the maintenance of law and order, as high in proportion to her wealth as Western nations.

“Her expenditure on social services such as education, health, sanitation, etc., on the other hand, is far behind Western standards and indeed in many directions is almost non-existent.

“The insufficiency of India's revenues to provide adequately for the latter classes of expenditure has been a factor of political importance in that it has created dissatisfaction with the very small headway that it has been possible to make in the direction of social amelioration under the Reforms.”

The percentage of taxation to income for Britain, Japan and India is 20 per cent., 20 per cent., and 8 per cent., respectively. According to Mr. Layton the revenue in India can increase provided the tax “incidence is adjusted to the capacity of taxpayers to pay and that heavy additional burdens are not put upon primary necessities”. Secondly, the proceeds should be wisely spent to increase the wealth production and efficiency of the people of the country. The economic welfare of the country can increase if public expenditure is so designed as to give greater economic security, better physical well-being and education.

The reasons for inadequate revenues in India are:—

Firstly, the elected representatives are not willing to incur the unpopularity of voting increased taxation so long as there are no means of ensuring that the revenue will be spent on nation-building departments to an adequate extent. The Central Government is not permitted by the constitution to subsidise the social services falling within the provincial sphere; “and in any case there are very definite limits to the extent to

which an irresponsible Government can force increased taxation on a poor country."

Secondly, there is lack of harmony between the distribution of functions on the one hand and the allocation of sources of revenue between the provinces and the Centre on the other, with the result that the functions falling within the provincial sphere require large expenditure, but the provincial revenues are inelastic.

Thirdly, the present settlement has left the provinces very differently situated financially, which has created dissatisfaction and the endeavour of the provinces has been to secure a redistribution of the existing resources rather than to try to increase the total available funds.

Finally, it is evident "that the dominant factor in India's financial situation is her large expenditure on the army". Mr. Layton does not, however, think that a reduction in the expenditure on defence will produce adequate revenues to enable the country to make satisfactory progress socially and economically.¹

The following conditions should be the main features of financial reforms in India :—

"(a) that responsibility for imposing additional taxation is definitely laid upon those who will have to incur additional expenditure ;

"(b) that sources of revenue appropriate to their requirements are available to those authorities who have urgent and expanding services to administer, and

"(c) that all parts of India shall make an equitable contribution to common purposes."

As explained above,² India had a highly centralised system of administration before the Reforms. The main heads of revenues collected within the provinces were divided between them and the Central Government and subsidies from the Centre to the provinces were an important feature of the financial arrangements. The total provincial revenues were based on provincial needs in theory, though in practice they were the result of tradition and history.

The Montagu-Chelmsford Report proposed to give the provinces a constitutional control over certain resources which they would increase or decrease as they liked. In fact, they laid down that all the Indian fiscal resources should be at the disposal of the provinces subject to some deduction for the

¹ This view cannot be accepted because a reduction in the military expenditure in India to the pre-War level will make a net annual saving of Rs. 15 crores, which should ease the financial situation very considerably to enable the country to make progress socially and economically.

² See Chapter IX.

requirements of the Centre. This doctrine was not, however, carried to its logical conclusion by assigning all revenues to the provinces and making them contribute to the central exchequer on a certain basis. This could be possible only when the federation of independent states came together for the first time; though even in such cases this method has rarely been followed, the general plan being to allocate to the central authority certain definite sources of revenue. For example, in the case of the federation of the thirteen original states of the U. S. A., the customs revenue was from the beginning assigned for federal purposes.

The idea that all revenues should be provincialised cannot work unless the provincial units have full power to determine the scale and nature of the expenditure of the Central Government. The Centre should have certain specific sources of revenue of its own so long as it has the power to determine its budget independently. The Montagu-Chelmsford Report, therefore, sought to solve the problem by abolishing the divided heads of revenue and allocating some of them to the provinces and others to the central exchequer. The conception of all taxes being provincialised was even more specifically given up in the Government of India Act inasmuch as the residuary powers of taxation were given to the Central Government.

The award of the Meston Committee was criticised on the following grounds:—

(a) The provincial sources are inelastic though they have growing needs; but the case with the Centre is the reverse.

(b) The provinces were given unequal treatment, because some of them were given a much greater proportionate increase of revenue than others.

FINANCIAL SITUATION

Budget estimates of Revenue and Expenditure of Central and Provincial Governments in 1929-30 (*in crores of rupees*)³:—

CENTRAL REVENUE			CENTRAL EXPENDITURE		
Customs ..	..	51.22	Defence (net) ..	..	55.10
Income-tax ..	..	16.60	Debt Charges (net) ..	..	12.19
Salt ..	..	6.35	Civil Administration		
Other Taxes ..	..	1.19	(net) ..	..	11.56
			Loss on Post Office, Irrigation and Forests ..	..	.39
Total Taxes ..	..	75.36	Cost of Collection ..	..	3.32
Railways (net) ..	..	6.25	Civil Works (net) ..	..	2.41
Opium (net) ..	..	2.35	Pensions ..	..	2.78
Currency and Mint (net)		2.35	Other Expenditure (net)		.47
Tributes from Indian States ..	..	.74			
Other Receipts (net)		1.17			
Total ..	..	88.22	Total ..	..	88.22

³ Report of the Indian Statutory Commission, Vol. I, p. 215.

PROVINCIAL REVENUE			PROVINCIAL EXPENDITURE		
Land Revenue	..	35.48	Land Revenue and		
Excise	..	19.44	Central Administration	15.76	
Stamps	..	14.35	Police	..	12.28
Registration	..	1.47	Jails and Justice	..	8.31
Scheduled Taxes	..	.39	Debt	..	3.21
			Pensions	..	4.05
Total Taxes	..	71.13	Education	..	12.57
Forests (net)	..	2.07	Medical and Public		
Irrigation (net)	..	2.77	Health	..	6.38
Other Surpluses of			Agriculture and Indus-		
Revenue	..	12.28	tries	..	3.53
			Civil Works	..	11.84
			Other Expenditure	..	9.00
Total	..	88.25	Total	..	86.96

The following table compiled from the *Indian Year Book* gives the revised budget estimates for 1933-34 and 1934-35:—

(Figures in Crores of Rupees)

Revenue		1933-34	1934-35
Principal Heads of Revenue—			
Customs	.. ..	46.87	48.48
Taxes on Income	.. ..	17.13	17.25
Salt	.. ..	8.55	8.73
Opium	.. ..	1.59	.95
Other Heads	.. ..	1.86	1.82
Irrigation Receipts	.. ..	..	..
Interest	.. ..	1.59	1.86
Civil Administration	.. ..	.77	.78
Civil Works	.. ..	.24	.24
Currency and Mint	.. ..	1.23	1.27
Miscellaneous	.. ..	.68	.57
Extraordinary Receipts	.. ..	.36	..
Posts and Telegraphs (net)	.. ..	.32	.70
Railways	.. ..	32.87	32.58
Defence	.. ..	5.25	5.20
Total	.. ..	119.31	120.43
Expenditure		1933-34	1934-35
Customs	.. ..	.99	1.01
Taxes on Income	.. ..	.83	.85
Salt	.. ..	1.14	1.15
Opium	.. ..	.72	.42
Other Heads	.. ..	.59	.58
Irrigation	.. ..	.04	.06
Civil Administration	.. ..	9.59	9.59
Currency and Mint	.. ..	.61	.66

Expenditure	1933-34	1934-35
Civil Works	2.07	2.02
Allowances and Pensions	2.96	3.08
Miscellaneous	1.30	1.25
Extraordinary Expenses	1.39	.03
Posts and Telegraphs :		
Interest on Debt .. ..	.83	.84
Railways	32.87	32.58
Defence Services	49.67	49.58
Interest	9.66	10.34
Reduction of Debt	3.00	3.00
Miscellaneous Adjustments	1.00	3.16
Total	119.31	120.24

The above table shows the following facts :—

(a) The expenditure on defence, civil administration and debt amounts to a very large proportion of the total expenditure, and

(b) The expenditure on nation-building departments in the provinces is very low.

“An outstanding feature of this summary is the high proportion ($62\frac{1}{2}$ per cent.) which current expenditure on defence bears to the total expenditure of the Central Government—a higher proportion in fact than in any other country in the world..... It is more significant that even when account is taken of provincial and central expenditure together, the ratio ($31\frac{1}{2}$ per cent.) is still a very high one..... Security is, of course, essential, if production is to develop; but it cannot be claimed for expenditure on defence either that it is a mere redistribution of income or that it promotes productive efficiency. Indeed, economically speaking, it is the most burdensome form of expenditure, and this is particularly the case where, as in the case of India, the army contains a large element drawn from elsewhere. If, therefore, the high ‘defence ratio’ in Indian Government expenditure is partly due to the low level of other expenditure, it remains a peculiarly burdensome one, and it would be reasonable to assume that, even if the total expenditure of India were increased, the burden would be more tolerable and more readily borne, provided this particular charge were diminished.”⁴

The following table of figures giving a comparison of the military expenditure of various countries of the world shows that India is seventh on the list in this respect among the Great Powers and that her defence expenditure is between

⁴ See *Ibid.*, p. 216.

two and three times as great as that of the whole of the rest of the Empire excluding Great Britain. The figures are⁵ :—

U. S. A.	..	..	4,453	million gold francs
Great Britain	..	..	2,900	" "
Russia	..	..	2,440	" "
France	..	..	2,286	" "
Italy	..	..	1,333	" "
Japan	..	..	1,215	" "
India	..	..	1,069	" "
Germany	..	..	942	" "
Rest of the British Empire	..	..	370	" "

Mr. Layton in his Report says that "It is relevant to my present purpose to point out that the total is at present so large, both absolutely and in relation to the revenues of India, as to be a dominating factor in the financial situation."

STATEMENT COMPARING THE ACTUAL REVENUE AND EXPENDITURE OF THE CENTRAL GOVERNMENT SINCE 1921-22

(In Lakhs of Rupees)

Year	Revenue	Expenditure	Surplus (+) Deficit (-)
1921-22	1,15,21	1,38,40	-27,65
1922-23	1,21,41	1,31,88	-15,02
1923-24	1,33,17	1,27,16	+ 2,39
1924-25	1,38,04	1,28,58	+ 5,68
1925-26	1,33,33	1,25,05	+ 3,31
1926-27	1,31,70	1,23,77	+ 2,96
1927-28	1,25,04	1,22,22	- 2,21
1928-29	1,28,24	1,23,88	- 32
1929-30	1,32,69	1,26,68	+ 27
1930-31	1,24,60	1,30,04	-11,58
1931-32	1,21,64	1,26,50	-11,75
1932-33	1,26,40	1,18,01	+ 1,55
1933-34	1,19,31	1,15,02	Surplus to earthquake fund
1934-35	1,20,43	1,15,10	+ 4,95
1935-36 (Revised)	86,52*	84,10*	+ 2,42*
1936-37 (Budget)	87,35*	85,30*	+ 2,05*

The above figures show that the years of deficits have been more frequent than years of surplus, and in some years the deficits have been very great.

⁵ P. Jacobson, *Armaments Expenditure of the World*. Also see *World Economic Survey*, 1932-33, p. 174. The figures in the latter book are in national currencies and consequently are not comparable.

* Figures are net.

The following table shows the yield of the principal sources of revenue :—

(In Crores of Rupees)

Year	Customs	Income-tax	Railways	Salt	Opium
1921-22	34.41	18.74	9.09	6.34	1.27
1922-23	41.35	17.99	1.22	6.82	1.92
1923-24	39.70	18.24	6.44	10.02	1.66
1924-25	45.75	16.01	6.78	7.39	1.44
1925-26	47.78	15.86	5.49	6.33	2.04
1926-27	47.38	15.65	6.01	6.70	3.33
1927-28	48.21	15.06	6.28	6.63	3.08
1928-29	49.28	16.70	5.23	7.60	2.72
1929-30	49.72	17.10	6.12	6.72	2.19
1930-31	53.40	18.00	5.74	7.05	2.07
1931-32	..	..	7.35	..	..
1932-33	52.28	17.70	5.22	9.23	.08
1933-34	46.96	17.30	..	7.38	..
1934-35	..	..	..	..	..
1935-36	54.71	16.80	..	..	..
1936-37 Budget	54.82	17.60	..	..	..

The above figures show that the revenue receipts from the principal sources are having a downward trend and this in spite of the extraordinary taxation of 50 crores of rupees that has been imposed during the last five years.

REVENUE PROSPECTS

Regarding the revenue prospects the conclusions of Mr. Layton may be summarised as below :—

(1) The key to the situation will be found in the yield of customs revenue.

(2) This would depend upon the state of the monsoon. "A monsoon failure would, however, affect the general purchasing power of the country, and, therefore, the receipts from customs; and although transport development, the diversification of India's economic activities and any rise that may have taken place in the standard of life in certain parts of India may mitigate its effect, it would not be prudent to assume that the steady rise of imports and of customs revenue that has taken place in the last decade, will continue without interruption. Indeed the rise has been checked at the moment by the almost universal set-back to trade."

(3) India's economic development would be more rapid than in the past owing to the completion of some gigantic irrigation projects, railway and road development and the development of harbours. These factors would improve the state and volume of India's trade.

(4) The fiscal policy would play an important part. Certain duties were regarded by him as beyond the point of maximum yield and he, therefore, pointed out that more revenue might be obtained from a general lowering of rates.

(5) A revenue of nearly Rs. 100 crores was anticipated to be realised by 1940 from the existing central sources.

EXPENDITURE

CHIEF ITEMS OF EXPENDITURE

(In Crores of Rupees)

Year	Military Services	Civil Services	Debt Services
1921-22	69.81	8.64	14.89
1922-23	65.27	9.50	15.00
1923-24	65.23	8.65	14.17
1924-25	55.63	9.39	15.27
1925-26	56.00	9.87	14.12
1926-27	55.97	10.28	12.66
1927-28	54.79	10.22	11.99
1928-29	55.10	10.43	12.82
1929-30	55.10	11.56	12.19
1930-31	54.35	12.20	14.36
1931-32	..	..	..
1932-33	46.74	20.89	..
1933-34	46.20	20.53	..

The military budget which stood at 55.1 crores in 1928 was expected to remain at the same figure until 1932-33 and thereafter to drop to a lower figure in three ways. Firstly, India was expected to be relieved of the capitation charges amounting to Rs. 2 crores annually. This expectation has in part been realized owing to the award of the Capitation Tribunal. Secondly, the progressive Indianisation of the officers of the Indian Army was another method of effecting a saving therein. Thirdly, "the substitution of Indian Army units for the much more expensive units of the British Army in India," would reduce this expenditure but the Joint Parliamentary Committee did not make any satisfactory recommendations in connection therewith and the new Act also is on the same lines.

Regarding the cost of general administration, Mr. Layton pointed out "that the Indian Government is expensive, owing to the level of salaries in the upper grades of the Indian Services, which have had to be fixed on a standard high enough to induce British members to leave their home country and to work for the best part of their lives in an uncongenial climate"; but he regarded that these standards would continue for the British personnel and pointed out that the salaries of the British and the Indian Officers should be the same but that the overseas allowances of the former could be increased. Without an increase in the additional duties upon the Central Government, he did not anticipate an increase in the total expenses under this head. The total debt charge was expected by him to come down.

PROVINCIAL EXPENDITURE

Regarding provincial expenditure, Mr. Layton concluded as below :—

"In short, so long as the State is unable to acquire a share of the increment in the value of land in the form of land revenue, irrigation dues or in some other way, and so long as the present allocation of sources of revenue persists, there is no direction in which the provinces can look for a substantial or even a continuous increase in revenues, except under the heading of Stamps."

The following two tables show the position of provincial revenues from 1921-22 to 1928-29 :—

PROVINCIAL REVENUES, 1921-29

(In Lakhs of Rupees)

(a) Gross Revenues (before deducting provincial contributions)

Year	Madras	Bombay	Bengal	U. P.	Punjab
1921-22 ..	1,523	1,367	895	1,242	885
1922-23 ..	1,606	1,473	985	1,246	1,003
1923-24 ..	1,647	1,509	1,013	1,271	1,091
1924-25 ..	1,627	1,555	1,034	1,240	1,153
1925-26 ..	1,693	1,558	1,071	1,270	1,266
1926-27 ..	1,683	1,486	1,050	1,289	1,171
1927-28 ..	1,700	1,534	1,081	1,286	1,206
1928-29 ..	1,753	1,522	1,099	1,145	1,116

Year	Burma (including Shan States)	Bihar and Orissa	C. P.	Assam	Coorg	Total
1921-22 ..	982	443	494	196	..	8,027
1922-23 ..	950	494	537	199	..	8,493
1923-24 ..	980	528	539	226	..	8,804
1924-25 ..	1,095	537	547	245	15	9,048
1925-26 ..	1,113	579	548	259	14	9,371
1926-27 ..	1,104	574	529	258	13	9,157
1927-28 ..	1,126	572	540	269	14	9,328
1928-29 ..	1,112	578	536	274	14	9,149

(b) *Net Revenues (after deducting provincial contributions)*

Year	Madras	Bombay	Bengal	U. P.	Punjab
1921-22 ..	1,146	1,311	832	1,002	710
1928-29 ..	1,753	1,522	1,099	1,145	1,116
Increase per cent.	53	16	32	14	57
Population in millions	42.3	19.3	46.7	45.4	20.7

Year	Burma (including Shan States)	Bihar and Orissa	C. P.	Assam	Coorg	Total
1921-22 ..	918	443	463	181	..	7,006
1928-29 ..	1,112	587	536	274	..	9,144
Increase per cent.	21	30	16	50	..	30
Population in millions	13.2	34.0	13.9	7.6	..	243.1

PROVINCIAL REVENUES AND CENTRAL REVENUES COLLECTED
IN THE PROVINCES—1928-29

(In Lakhs of Rupees)

	Madras	Bombay	Bengal	U. P.	Punjab
PROVINCIAL. Land Revenue	525	485	327	604	278
Excise ..	559	392	225	131	121
Stamps ..	251	168	355	173	121
Income-Tax (D. R. 15) ..	5	..	..	..	4
Irrigation (net) ..	183	66	1	85	374
Forests ..	62	73	31	62	35
Other Heads ..	168	338	160	90	182
TOTAL ..	1,753	1,522	1,097	1,145	1,115

	Burma	Shan States	Bihar and Orissa	C. P.	Assam	Total
PROVINCIAL. Land Revenue	540	5	174	219	117	3,274
Excise ..	133	1	189	123	66	1,940
Stamps ..	71	..	110	70	22	1,341
Income-Tax (D. R. 15) ..	12	..	5	2	7	35
Irrigation (net) ..	33	..	21	..	..	761
Forests ..	161	20	11	54	38	547
Other Heads ..	105	32	68	68	24	1,235
TOTAL ..	1,055	58	578	536	274	9,133

	Madras	Bombay	Bengal	U.P.	Punjab
CENTRAL (Collected in Provinces)					
Customs ..	469	1,921	1,850	..	9
Taxes on Income ..	131	317	615	90	61
Salt ..	148	158	176	..	..
Opium ..	..	..	..	327	..
Other Heads ..	19	88	36	5	31
TOTAL ..	767	2,484	2,677	422	101

	Burma	Shan States	Bihar and Orissa	C. P.	Assam	Total
CENTRAL (Collected in Provinces)						
Customs ..	657	..	..	..	23	4,929
Taxes on Income ..	185	..	91	33	15	1,538
Salt ..	35	..	..	..	..	517
Opium ..	..	..	..	..	..	327
Other Heads	10	..	3	3	1	196
TOTAL ..	887	..	94	36	39	7,507

The figures for transferred services are as below :—

EXPENDITURE

(In Lakhs of Rupees)

	1922-23	1929-30	Increase	Percentage Increase
Madras ..	411.3	763.8	352.5	86
Punjab ..	299.0	542.7	243.7	82
U. P. ..	298.0	388.2	90.2	30
Bombay ..	453.5	567.6	114.1	25
Bengal ..	353.9	404.0	50.1	14

The following table shows the expenditure on nation-building services separately :—

PERCENTAGE INCREASE BETWEEN 1922-23 AND 1929-30.

			Education	Medical Relief and Public Health
Madras	..	..	82	115
Punjab	..	..	78	94
U. P.	..	..	47	67
Bombay	..	..	23	43
Bengal	..	..	21	24

The main conclusions regarding provincial budgets are as below :—

“(a) As a result of the division of resources in 1920 the provinces received substantially increased spending power as compared with the pre-War situation, and though higher salaries and prices absorbed a large amount of the increase, they have been able to finance the considerable expansion of social services that has taken place all over India in the last decade.

“(b) The benefit was, however, unequally felt owing to the fact that for historical and other reasons certain specific items of revenue are productive to varying extents in the different provinces.

“(c) The growth of revenue continued fairly generally during the first half of the decade partly as a result of new minor taxes and higher rates of stamp duty and also through the assessment of newly irrigated land.

“(d) The full effect of the allocation was not felt until the final abolition of the contributions. This gave the contributing provinces further increases of revenue and enabled them to continue the expansion of their services during the last half of the decade ; but it increased the disparity that had already been created. Other provinces have had the difficulty in making even small increases in expenditure, and in Bengal the expansion of educational and other services had practically ceased.

“(e) From now onwards any increase of revenue from existing sources—except receipts from large irrigation schemes mainly in the Punjab and Sind—is likely to be small. The small stagnation of other revenues will affect all provinces alike.”⁶

NEW SOURCES OF REVENUE

A case has been made out in the Report of the Indian Statutory Commission for an increase in revenue. It is

⁶ *Report of the Indian Statutory Commission*, Vol. II, p. 235.

suggested that the tax revenue of India is capable of being increased provided that the incidence of taxation can be adjusted to the taxable capacity of the various classes of people. It is pointed out that though on theoretical grounds, direct taxes are preferable to indirect taxes because their incidence can be definitely determined and they are economical to the taxpayer inasmuch as he is not called upon to pay more than the Government receives, yet to suit Indian conditions, the latter are necessary. The principal items of taxation suggested are :—

Firstly, the exemption limits of income-tax should be lowered and there is considerable scope for steepening the progression of the rate of income-tax on incomes between Rs. 5,000 and Rs. 100,000. It may be remarked that this has already been done. The provisions relating to income from foreign investments should be amended so that it may be possible to tax same whenever it comes to India.

Secondly, there should be taxation of agricultural incomes. The exemption is neither supported by fiscal theory nor by practical considerations and expediency. In the permanently-settled provinces and elsewhere also, the tendency for land revenue is to remain fixed. It is also said that the net value of the land produce has increased much in recent years, but that the tax-gatherer has not gained any share of the increase. This can be done either by adjustments of land revenue assessments or by imposing income-tax on agricultural incomes. The latter plan is preferred by the Indian Statutory Commission. It may be said in this connection that the heavy fall in prices after the Statutory Commission had made this recommendation has changed the situation entirely in this respect.

The principal advantage of levying income-tax on agricultural incomes according to the Commission is "that it will subject the non-agricultural earnings of people who own land to a higher rate of income-tax. For instance, if the income from all sources of rural money-lenders, who are often landholders, were taxed, not only would more income become liable to tax but the tax would be assessed at a higher rate". (Page 240 of the *Report of the Commission*, Vol. II.)

Thirdly, a large income is not expected from death duties and it is suggested that if levied, the tax would have to be administered by a central authority and distributed among the provinces.

Fourthly, an excise duty on factory produced tobacco and matches is recommended. The two excises at the end of 10 years were expected to yield 7 or 8 crores. It may be said that in the budget for 1934-35 these duties were imposed and many others also besides them.

Fifthly, terminal tax was also recommended and it was estimated that in course of time it might be capable of yielding 10 crores easily. Its main objections, namely, that it might impede trade and prevent specialised production and that it might impede short distance traffic, were dispensed with in the Report with a remark that if levied at a low rate and subject to the approval of the Government of India, it could work with advantage. When motor traffic develops, its applicability should be considered in that connection also and that it should be levied on river traffic also. It should not be regarded as a permanent feature of India's financial system, but rather as one suited to a country in a comparatively early stage of development and that its imposition is sanctioned by the precedent of European countries. Subject to these considerations, it could be made a fruitful source of revenue.

Finally, the limit of one anna in the rupee of the local cess on land was recommended to be abolished to increase the yield of the cess.

PRINCIPLES OF DISTRIBUTION OF REVENUES

Substantial sums of money must be collected by a central agency and distributed among the provinces on some agreed basis to meet nation-building services. The proposal to recognise the right of the provinces to all the revenues which arise in them and to finance the needs of the Centre by provincial contributions was rejected by the Commission, *inter alia*, on two main grounds. "Firstly, that if there are to be no internal barriers in India customs duties and similar taxes must be collected at a uniform rate, and in any case can most conveniently be collected by a central organisation; and secondly, that the plan would involve conferring on the Central Government the right to intervene and to compel a defaulting province to produce its quota." Thirdly, the scheme is based on the assumption that each province has some natural right to the revenues which are collected in it. This is not so; because the customs revenue collected at the main ports is tax paid to some extent by people throughout India and not merely by the people in the province where the port is situated. No principle of allocating the customs revenue according to the place of consumption of imported goods would work satisfactorily. Similarly, in the case of income-tax on profits it is impossible to say whether these profits arise in the province where the head office is situated; because a big business may have branches in many provinces. Even, if the administrative difficulties could be overcome, the yield within the borders of a province could not be said to be legitimately its own share. The prosperity of big towns depends upon the prosperity of the country as a whole. The expansion in the revenue from

income-tax, say, in Bombay would be due in a great measure to the fact that the imported goods are consumed elsewhere.

DISTRIBUTION ACCORDING TO NEEDS

The existing provinces on these grounds were regarded as unsuitable fiscal units. It is thus necessary that some of the revenues of India should be redistributed according to the needs of the various provinces. The income from taxes on profits and on trade cannot be earmarked to the benefit of the territory in which it happens to be levied and it arises from the economic activities of the whole country. Further, large areas should not be left in a backward state of development. It does not, however, mean that a uniform standard should be enforced all over India ; while the rapidly advancing provinces should be really left to make the pace for others. But it is really not desirable to leave the backward provinces without resources to follow the lead of the progressive ones. This difficulty can be overcome by readjusting some of the proceeds of taxation according to needs.

LIMITATIONS OF THE PRINCIPLES OF NEEDS

The principle of distribution of revenues according to needs has its limitations. Firstly, a province which feels that part of its taxation is being used for other provinces would resist the imposition of taxation and there would be no incentive to develop taxation properly. Secondly, a province receiving revenue which it does not collect would spend same carelessly and thus it would encourage extravagance. Thirdly, the developing resources throw responsibilities on the particular provinces where they develop and involve them in increasing expenditure. It would be unfair to deprive such provinces of the revenues increasing from their economic progress. Therefore, the principles of distribution according to origin and on the basis of population remain the only two practicable principles.

POSSIBILITY OF CENTRALISING SERVICES

The problem could be solved by a centralisation of nation-building services or by adopting a system of grants-in-aid. But the arguments against any such solution are very weighty. Firstly, the advance is likely to take place more rapidly in the provinces than at the Centre and to transfer more financial control to the Centre would be a backward step. Secondly, the important field of training in civic responsibility and affairs will be the provincial legislatures as they will have to direct the social services. Thirdly, the nation-building services cannot be directed efficiently from a single centre.

DISTRIBUTION ACCORDING TO POPULATION

The principle of distribution according to population seems to be simple, intelligible and equitable, and the cases of other countries offer some precedents in this direction. The finances of the German Zollverein were organised on this basis and the system was till recently prevalent in the Australian Commonwealth and in the Dominion of Canada. "To distribute the whole or even the larger part of the revenues of India on this principle would certainly be unfair; and would severely penalise those provinces which have already made great headway; but, if a suitable proportion of centrally collected revenues were distributed on this basis, it would introduce just that kind of corrective that is needed to adjust some of the present inequalities between the provinces without introducing complicated formulæ or making separate arrangements with regard to every class of revenue." (Page 250 of the *Report of the Statutory Commission*, Vol. II.)

The conditions to which any new financial settlement must conform may be summarised as below:—

"(a) We must envisage an additional expenditure of at least 40 to 50 crores of rupees by 1940, in order to finance the expanding functions of Government, most of which will fall within the sphere of provincial governments.

"(b) There is no prospect of existing provincial revenues expanding to meet these requirements.

"(c) After the loss of the opium revenue has been made good by the expansion of other items in the central budget, and certain claims have been met, and assuming peace and internal order, there should, in course of time, emerge a surplus over existing items of central expenditure. In the absence of a rapid expansion of the functions of the Central Government, or a policy of drastic tax remission, this surplus should become available for provincial purposes. The extent of this surplus will be largely affected by the extent of India's future expenditure on defence and by her fiscal policy.

"(d) This central surplus, however, will, in any case, be quite insufficient for the purposes envisaged, and provincial revenues must, therefore, be supplemented by new forms of taxation, most of which should be uniform all over India, and centrally collected.

"(e) In order to maintain the essential connection between spending and raising revenue, the responsibility for imposing these new taxes must rest upon the representatives of the provincial legislatures.

"(f) Continuous and detailed administrative control by the Central Government over the functions referred to in (a) above will not be practicable, and it will, therefore, not be

possible to finance a large proportion of provincial expenditure by means of grants-in-aid out of centrally collected revenues.

“(g) Hence a simple and automatic basis must be found for the distribution to the provinces of centrally collected revenues. This basis must be permanent, or at all events, only changeable by general agreement of the provinces.

“(h) The system of distribution must enable a province to benefit from its own economic development and from the enlargement of its own tax-producing capacity. In other words, it must receive some benefit from an increase of the revenue which arises within it. In particular, a case has been made out for enabling the industrial provinces to benefit to some extent from the increase in revenue arising from their industrial activities.

“(i) The haphazard geographical distribution of the provinces makes it, however, inequitable to distribute all centrally collected taxes on the basis of the province from which they arise, and the distribution must to some extent accord with the needs of the various provinces. The only satisfactory automatic test of this kind is population.

“(j) The complete scheme should, therefore, be based in part upon distribution according to population. The desired compromise between these two principles can be obtained by assigning the various sources of revenue to be distributed according to one or other of them.” (Pages 250–251 of the *Report of the Statutory Commission*, Vol. II.)

APPLICATION OF THE FOREGOING PRINCIPLES

Indian revenues were considered under four heads in the *Report of the Indian Statutory Commission*.

(a) Revenue collected and spent by the Central Government ;

(b) Revenue collected and spent in the provinces ;

(c) Revenue collected by the Central Government and distributed to the provinces according to the basis of origin ; and

(d) Revenue collected by the Central Government and distributed to the provinces on the basis of population.

Under the first head a surplus of $14\frac{1}{2}$ crores was estimated to be realised at the end of 10 years on the basis of existing taxation as below :—

1. Expansion in the customs revenue at the rate of about $\frac{3}{4}$ crores a year, giving $7\frac{1}{2}$ crores at the end of 10 years ;

2. An increase of at least 4 crores in income-tax due to a reduction in income-tax limit, taxation of income from foreign investments and greater progression ;

3. Saving in the military budget which was expected to be counterbalanced by increased civil expenditure ; and

4. Increase in railway receipts, but for this no credit was allowed owing to the urgent need for a reduction in rates and fares and for obsolescence of railways. An allowance of 2 crores was made for the disappearance of the opium revenue.

RE-ALLOCATION OF REVENUES

Foreign Liquor.—To avoid conflict of interests between the Central and the Provincial Governments, it was proposed that the customs duty should be brought into relation with the excise policy of the provinces by reducing the customs duty to the standard luxury rate of 30 per cent. and by giving the provinces the right to impose further duties on foreign liquor in the form of excises. In this way the provinces would gain $1\frac{1}{2}$ crores and they would also have the advantage of controlling the taxation level on alcohol consumed within their borders. This would also increase their excise revenue substantially, because "the present customs duties are very low as compared with the corresponding duties imposed in the country."

Commercial Stamps were recommended to be centralised so that the revenue might as far as possible be assigned to the authority which controlled the rates of duty. Centralisation would also prevent competition between provinces by creating uniform rates.

Income-Tax.—A substantial portion of the income-tax revenue should be assigned to the provinces either on the basis of the collections made within a province; or the basis of allocation should be the tax paid by the residents of the provinces on their income from all sources, including the income from dividends received by them from companies carrying on their business elsewhere also. The latter method was preferred by Mr. Layton; though the method has the disadvantage because it does not take into account incomes earned in India of persons living abroad, or of the tax levied upon the undistributed profits of companies.

Salt Duty.—The proceeds of the salt duty should also be transferred to the provinces on the population basis, which would cost the Central budget $5\frac{3}{4}$ crores net.

This transfer was to be gradual according to a certain schedule so that the loss of revenue to the Central Exchequer should be about $1\frac{1}{4}$ to $1\frac{1}{2}$ crores a year. Exceptional circumstances might postpone the transfer, but the agreement between the Centre and the provinces would provide that this transfer ought to be a first charge on the surplus, the delay to be made good subsequently.

NEW PROVINCIAL TAXES

Agricultural Incomes should be taxed by removing their exemption and the whole of the proceeds should be allocated to the provinces in which they are collected.

Surcharge on Income-Tax.—It was suggested that the provinces should be allowed to impose a surcharge amounting to one-quarter of the tax on personal incomes or one-half of that which would be transferred to them under the scheme of the Statutory Commission. At the end of ten years, this was expected to produce a revenue of three crores.

Terminal Taxes.—Provinces should also be empowered to levy terminal taxes which might produce about 10 crores at the end of ten years. They would enable the provinces to vary the level of direct taxation and to impose a general consumption tax capable of producing good revenue.

A Provincial Fund should be established to which excises on cigarettes, matches and the salt duty would be transferred. At the end of 10 years this fund would be provided with an annual yield of 14 crores. It should be distributed among the provinces on a *per capita* basis, which would benefit the poorer provinces to a certain extent.

Item (a) revenues raised and spent by Central Government would thus include customs, income and super-tax less the assignment of half the personal income-tax to the provinces, commercial stamps, railway profits and profits from central services. In the eventuality of the emergence of a further surplus, a certain proportion of the customs revenue should go to the Provincial Fund. Further, the Central Government should have the power to raise additional revenue for emergency purposes. In order that the Provincial Fund might not be directed by the emergency powers of the Central Government, the latter should consist in the right to make surcharges on certain taxes only.

Item (b) revenues raised and spent by the provinces would include terminal taxes and the right to levy surcharges on personal incomes subject to income-tax. In order to prevent harmful reactions on inter-provincial trade, the maximum rates to be levied by the provinces should be fixed.

Group (c) including taxes centrally collected but distributed to provinces according to origin would include 50 per cent. of the yield of personal income-tax allocated to the provinces and the tax on agricultural incomes.

Group (d) would include All-India taxes collected centrally but distributed according to population and it would also include the general excises.

The provincial situation at the end of 10 years was estimated to be as follows :—

	In crores of rupees	
Existing revenue (budget 1929-30) ..	..	78
Existing revenue (budget 1929-30) ..	..	78
Group (b)		
Surcharge on personal income-tax ..	..	3
Terminal taxes .. ..	..	8
Group (c)		
Half personal income-tax ..	..	6
Tax on agricultural income ..	..	5
Group (d)		
Provident Fund .. ..	..	14
	Total ..	114

The Central Budget would be as below :

(In Crores of Rupees)

REVENUE				EXPENDITURE			
Customs (after allowing the				Defence .. ..	..	45	
loss of liquor duties) ..	54			Debt .. ..	..	10	
Income-tax ..	20			Civil Administration ..	..	13	
Less Provincial				Cost of collection ..	..	3	
share ..	6			Civil works ..	..	2½	
	—	..	14	Other items ..	..	3½	
Commercial stamps ‡ ..	2			Surplus ..	..	4½	
Railways (net) ..	6						
Miscellaneous ..	5½						
Total ..	81½			Total ..		81½	

The conception of a Provincial Fund fed by All-India taxes is essentially a federal idea and some machinery was, therefore, regarded necessary for discussion and action in relation to these taxes by the provincial governments themselves. It was suggested that this machinery should be an Inter-Provincial Financial Council consisting of the provincial Finance Ministers and the Finance Minister of the Central Government. This Council would meet once a year to consider proposals for changes in the taxes within the scope of the Provincial Fund. These proposals would be considered in the special session of the Assembly ; and the Governor-General-in-Council would not have the right to certify taxes for the Provincial Fund. The proposed changes would not come before the Council of State, and they would not be voted upon by the provincial legislative councils ; though it would be open to any council to indicate its views by a resolution.

GENERAL FINANCIAL RELATIONS

The following proposals were made regarding the financial relations of the provincial governments with the Central Government and with the Secretary of State :—

(a) At present the accounts of the provinces except in the U.P. are kept by a central service. It was suggested in this connection that the accounts should be provincialised,

which would be in keeping with the tendency to make greater fiscal autonomy. As the accounts of the provinces would increase and become complicated, this growing expense should not be put on the Central Government. Ultimately the accounts of the provinces would be kept by a provincialised service under the control of the provincial governments.

(b) The provincial balances are kept with the Central Government and the minimum balances to be held are prescribed. This system was not proposed to be altered because "the provincial governments have no organisation in being to supersede the existing one and would presumably have to enter into arrangements with the Imperial Bank of India. If and when a Central Bank is created in India, this institution will probably take over this function. Meanwhile, there are obvious advantages in the Government continuing to do this, but it should perform this service on a commercial basis, and should not attempt to make undue profits out of the business for the benefit of the central budget." (*Report of the Indian Statutory Commission*, Vol. II, p. 266.)

(c) Regarding the borrowing operations, the proposal was to set up in India a Provincial Loan Council, consisting of the provincial Finance Ministers and the Finance Minister of the Government of India. This Council would establish a borrowing programme, and lay down the regulations for borrowing. This would co-ordinate the policy of raising loans and prevent competition between the provinces themselves and between the provinces and the Central Government. With the gradual development of responsible government in India, external control over the borrowing operations of the central and provincial governments would disappear. The constitution of the Loan Council would have to be modified and the functions to be assigned to it may be similar to those of the Council of the Australian Commonwealth, which deals with the requirements of the Commonwealth Government and the Constituent States. A joint borrowing programme is established and provision is made for co-ordinating the issue of all loans through a single channel.

The raising of sterling loans is at present controlled by the Secretary of State for India, which has prevented the Government of India from coming into direct touch with the City and complicated the management of Indian finances. It was, therefore, suggested that this function should be transferred to the High Commissioner for India, who should be assisted by a small committee of experts of a standing similar to that of the members of the Finance Committee of the India Council. The existing provision requiring the authority of an Imperial Statute for sterling loans raised by the Secretary of State for India was recommended to be abolished, because

“ there is no corresponding provision in the case of loans raised by the Crown Colonies or the Dominions ”.

(d) The audit staff was recommended to be separated from the staff keeping the accounts, whether accounts were provincialised or not.

Regarding the claims of the States for a portion of the customs duties, the proposal of the Butler Committee that an expert body should be appointed to examine the claims and counter-claims was endorsed. The development of India's finances as laid down in the *Report of the Statutory Commission* would make the Central Government increasingly dependent on customs revenue and the taxation imposed on the population of the States would thus increase at a time when the cost of the Imperial burden would fall or remain stationary. “ It will thus strengthen the case for determining what is the burden that may in equity be imposed upon the States. Further, if uniform national excises are to play an increasing rôle in Indian finances, they will, if levied at the point of production, constitute a new form of taxation on the population of the States and make it still more important to find a means of harmonising the financial policy of the Indian States and of British India.”

BORROWING AND AUDIT UNDER THE NEW ACT

When Part III of the Government of India Act, 1935, comes into force, the powers vested in the Secretary of State in Council, of borrowing on the security of the revenues of India shall cease; but this will not affect the provisions of Part XIII of this Act relating to borrowing in sterling by the Secretary of State. According to Section 315 of the Act, the Governor-General-in-Council will not be empowered to raise sterling loans; but in lieu thereof, the Secretary of State may contract such loans on behalf of the Governor-General-in-Council. The latter will be able to exercise such borrowing powers only if at a meeting of the Secretary of State and his advisers the borrowing has been approved by a majority of the persons present.

A Province will be able to borrow money upon the securities of its revenues within the limits laid down by the Act of the Provincial Legislature. The federation may make loans to, or give guarantees in respect of loans raised by any Province and any sums required for the purpose of making loans to a Province shall be charged on the revenues of the federation.

A Province may not borrow outside India without the consent of the Federation nor may it raise any loan if any part of a loan made by the Federation or by the Governor-General-in-Council to the Province is still outstanding, or in respect of which a guarantee has been given by the Federation or by the Governor-General-in-Council. The Federation shall

not withhold such consent unreasonably, and in the event of a refusal to make a loan or to give a guarantee, the decision of the Governor-General in his discretion shall be final.

AUDIT AND ACCOUNTS

An Auditor-General of India shall be appointed by His Majesty, who shall exercise such powers in relation to the accounts of the Federation and of the Provinces as may be prescribed by an Order of His Majesty in Council, or by any subsequent Act of the Federal Legislature varying or extending such an order; but no Bill for such a purpose shall be introduced without the previous sanction of the Governor-General *in his discretion*.

The accounts of the Federation shall be kept in such form as the Auditor-General of India may prescribe with the approval of the Governor-General. The Auditor-General can also issue directions regarding the methods or principles in accordance with which any accounts of Provinces ought to be kept.

The reports of the Auditor-General of India relating to the accounts of the Federation shall be submitted to the Governor-General, who will get them placed before the Federal Legislature, and the reports of the Auditor-General of India, or of the Auditor-General of the Province as the case may be, relating to the accounts of a Province shall be submitted to the Governor of a Province, who shall get them placed before the Provincial Legislature.

A Provincial Auditor-General could be appointed by His Majesty to perform the same duties and exercise the same powers regarding the Audit of the Accounts of the Province concerned as would be performed by the Auditor-General of India. The former will be appointed, if the Provincial Legislature concerned passes an Act charging the salary of the Auditor-General of the Province on the Provincial revenues.

CHAPTER XI

Percy and Davidson Committees

THE Federal Finance Committee presided over by the Lord Eustace Percy and the Indian States Enquiry Committee presided over by Mr. Davidson were appointed in 1932 to enquire into the financial adjustments of the Federation and the British Indian Provinces on the one hand and those between the Federation and the Indian States on the other. No complete picture of the financial position of the Federation could be presented, except by co-ordinating the results of these Committees. The division of the work that was entrusted to each of these Committees was purely artificial and the two enquiries were necessarily linked together.

Their reports are thus closely connected and interdependent, though for purposes of convenience it was decided to entrust the enquiries to separate Committees. These reports have not evoked any general feelings of satisfaction or approval from the parties affected. The constitution of a Federal Finance Committee was opposed by several members of the first Round Table Conference¹ partly because it would delay the process of framing the constitution, partly on the ground that it was unnecessary, and partly from a fear that it might result in a departure from the principles accepted by the Sub-Committee presided over by Lord Peel.

Though the recommendations of the Peel Committee were endorsed by the Federal Structure Committee in their anxiety to expedite the framing of the new constitution, the former body did not feel sufficient confidence in their findings, but desired their conclusions to be tested by an expert Committee in the light of a careful estimate of the probable revenue and expenditure of the Federation and its Units. Bearing the close connection of the two enquiries in mind, the recommendations of these Committees may now be examined.

The main duty entrusted to the Percy Committee was to test the soundness of the classification of the sources of revenue into Federal and Provincial in the light of facts and figures, to estimate the financial position of the Federal and Provincial Governments on the basis of such allocation of revenues and to recommend the necessary adjustments for securing the financial equilibrium of the Federal Government and the Provinces. It was also to advise upon and examine the subjects of the pre-Federation debt, powers of taxation, new sources of revenue, the emergency powers of the Federal Government,

¹ *The Indian Review*, September 1932, page 617.

borrowing powers, the division of pension charges, etc. It was, therefore, necessary for the Committee to make a forecast of the financial position of the Federal and Provincial Governments in the near future. In view of the abnormal conditions of the country's finances, it was unavoidable for the Committee to make certain assumptions regarding the time required for the revival of trade and the restoration of comparatively normal conditions and as to the level of taxation. They could not help making these assumptions on these points. Though their assumption of three years as the period of return to normal conditions was too sanguine, yet the assumption of a longer period of depression would have involved an assumption as to the continuance for the same period of the existing burden of taxation and of an increase in that burden probably. An endeavour to look too far into the future would increase the speculative element in the calculations and it was probably safer to proceed on the basis adopted by them; but the subsequent facts have belied their assumption in this respect.

Their conclusions are of a gloomy character, but probably this is partly due to the difficulties inherent in the nature of the task entrusted to them. The abnormal financial depression prevailing in India as in other countries of the world, the inelasticity of her revenues, the inherent costliness of a modern system of administration, the uncertainty regarding the revival of trade and prosperity by a rise in world prices and the limitations imposed upon the enquiry by their terms of reference are undoubtedly responsible within limits for the cheerless and gloomy character of their findings.

The Committee could perhaps suggest some relief from taxation even with their restricted terms of reference, but unfortunately this was not done.

THE FEDERAL FORECAST

The following table given in the Percy Committee Report shows the estimates of the Federal income and expenditure.

REVENUE					<i>(In Lakhs of Rupees)</i>	
Customs ..	..	..	..	..	51,20	
Collection ..	..	..	..	..	90	
Net ..	..	..	..	..	—	50,30
Salt ..	..	..	..	..	6,70	
Expenditure ..	..	..	..	..	1,15	
Net ..	..	..	..	..	—	5,55
Opium ..	..	..	..	..	78	
Manufacture ..	..	..	..	..	73	
Net ..	..	..	..	..	—	05
Railways ..	..	..	..	..	..	5,00
Currency and Mint (net)	..	..	..	..	..	3,80
Carried over ..					64,70	

(In Lakhs of Rupees)

REVENUE (Contd.)

				Brought forward ..	64.70
Miscellaneous					
Ordinary	..	..	..	..	1.66
Reparations	..	..	..	..	30
Total	..	..	..	..	1.96
State Contributions	..	..	..	..	74
Income-taxes	..	..	..	..	18.00
Collection	..	..	..	..	80
Net	..	..	..	..	17.20
				TOTAL REVENUE ..	84.60

EXPENDITURE

Debt Services					
Interest (net)	..	..	..	..	11.25
Sinking Fund	..	..	..	..	6.50
Posts and Telegraphs (net)	..	..	..	..	nil.
Military Budget (net)	..	..	..	..	47.00
Frontier Watch and Ward	..	..	..	..	1.70
Civil Administration including Territorial and Political Pensions and excluding other pensions and cost of collecting revenue, and allowing 60 % for provincialisation of Accounts and Audit	..	..	..	..	6.85
Pensions	..	..	..	..	2.65
N. W. F. P. Subvention	..	..	..	..	1.00
Civil Works	..	..	..	..	1.60
Chief Commissioners' Provinces and Central Areas					
Revenue					2.86
Net					1.31
					1.55
				TOTAL EXPENDITURE ..	8.010

Surplus : 4.50 lakhs.

This forecast "has been based on the rates of taxation imposed by the First Finance Act of 1931; that is to say, we have not taken into account the special surcharges on customs, income-tax and salt at present in force. This is an assumption, which in all the circumstances, we feel obliged to make, but we do not wish to be understood to be expressing the view that the present level of taxation ought necessarily to be reduced. On the contrary, we think it might be wise to regard some at least of these surcharges as a possible reserve."

Thus on the existing basis of revenue and expenditure, the Federal Government was expected to have a surplus of 4.50 crores, and the Provincial Governments were expected to have a deficit in the aggregate of 3.82 crores in the year 1935-36 when the Federal Constitution was to have come into operation. Several questions of importance arise upon this estimate. Firstly, whether the Committee were right in adopting the existing level of revenues and expenditure. The extent to which retrenchment in expenditure could be effected is

a question into which the Committee did not go. On the existing scale of Federal expenditure and the existing sources and yield of revenues, a surplus of 4.50 crores was estimated to be available for distribution among the provinces.

By far the most important question relating to the allocation of sources between the central and provincial governments relates to the treatment of income-tax. (The Peel Committee held that taxes on income other than corporation tax should be treated as provincial sources of revenues. The arguments for this view are :—

1. that the Federal sources of revenue should be such as could be raised both from the inhabitants of British India and the Indian States also. As the States would resist the imposition of income-tax by the Federal Legislature, it would not be fair that the income-tax should be levied on the British Indian Provinces only ; and

2. that some provinces like Bengal can meet their deficits by provincialising the income-tax.

The arguments for income-tax being treated as a Federal source of revenue are :—

1. It would not be practicable to balance the Federal budget, if the income-tax were surrendered to the provinces.

2. Indirect taxes alone would not yield adequate revenue to balance the Federal budget and are objectionable inasmuch as they press more heavily upon the poor than upon the rich. The Peel Committee pointed out that Federations which began only with indirect taxation as a federal source were compelled to levy an income-tax on the profits of companies in some form or another and that for that reason the constitution had to be amended in the U. S.A. and Switzerland.

3. On the ground of uniformity of burdens upon the Units of Federation, the Peel Committee had recommended the provincialisation of income-tax ; but they did not carry the principle to its logical end. They recommended the imposition of a corporation tax corresponding to the super-tax on the profits of companies throughout India ; but they were not certain if the States would agree to the imposition of the corporation tax ; or even if they agreed to its imposition, they might not agree to the appropriation of its proceeds within the States to federal purposes. The Percy Committee pointed out that if the corporation tax were abandoned as a federal source of revenue, the Federal Government would lose the one direct tax which could be counted upon to make up for a fall in the customs revenue.

4. It would not be adhering to the principle of uniformity of burdens if after provincialising the income-tax, provincial contributions were to be introduced from which the States would be exempted. According to the Percy Committee the provinces

would be called upon to contribute for some time to come out of their income-tax receipts towards the finances of the Federal Government. There would thus be no proportionate special burdens upon the States. It would then be straightforward to treat income-tax as a Federal head of revenue and then distribute such federal surplus as may accrue to the provinces.

5. This procedure would obviate the sense of grievance among the provinces which would arise if they were to surrender a portion of what they might be encouraged to regard as their own source of revenue.

6. It would also avoid the difficult questions of the basis of contributions to the Federal Government.

The scheme as outlined by the Percy Committee regarding the distribution of income-tax is given below :—

Out of the total estimated yield of income-tax which came to 18 crores of rupees, 80 lakhs was the estimated cost of collection and 3 crores and 70 lakhs was to be retained by the Federal Government, being super-tax on companies and the tax on salaries of federal officers and personal income-tax and super-tax in federal areas. Out of the remaining $13\frac{1}{2}$ crores, 2 crores represented the collection of personal super-tax and was to be distributed on the basis of the actual collections from residents. Of the remaining $11\frac{1}{2}$ crores, about $1/7$ th would represent the estimated tax on the undistributed profits of companies and on the incomes of persons resident outside British India and was to be distributed on population basis. The remaining $6/7$ ths of $11\frac{1}{2}$ crores was to be distributed on the basis of the estimated share of personal income-tax creditable to each province. The following table given by the Committee sets out the position :—

Distribution of Income-Tax

Province	2 crores on collections of personal super-tax	$1/7$ th of $11\frac{1}{2}$ crores on population basis	$6/7$ ths of $11\frac{1}{2}$ crores on basis of personal income-tax without federal salaries	Total
Madras ..	7	30	1,46	1,83
Bombay ..	50	14	2,79	3,43
Bengal ..	1,10	32	2,63	4,05
U. P. ..	8	31	84	1,23
Punjab ..	2	15	74	91
Bihar and Orissa	13	24	65	1,07
C. P. ..	8	10	46	59
Assam ..	1	6	22	29
N. W. F. P. ..	1	2	7	10
TOTAL ..	2,00	1,64	9,86	13,50

PROVINCIAL CONTRIBUTIONS

If income-tax were to be made a provincial revenue, the Federal Government would be left with a deficit and for this reason and also to provide surplus of about 7 crores for the Federal Government, the provincial contributions abolished in 1928 were recommended to be revived. The basis of provincial contributions was to be the proportion of the shares of income-tax of the provinces. The aggregate contribution to be paid by the provinces was to be a fixed sum to be reduced gradually as and when the Federal Government could afford to do so. The provinces would contribute $8\frac{1}{2}$ crores and on the above-named basis the position would be as disclosed in the following table :—

Province	Surplus (+) or deficit (—) on the basis of present provincial revenues	Share of Income-tax	Contribution payable proportionally to the amount in column 3	Surplus (+) or deficit (—) if full contribution is paid
Madras ..	—20	1,83	1,15	+48
Bombay				
excluding Sind	—65	3,22	2,03	+54
Bengal ..	—2,00	4,05	2,55	—50
U. P. ..	+25	1,23	78	+70
Punjab ..	+30	91	57	+64
Bihar and Orissa	—70	1,07	68	—31
C. P. ..	—17	59	37	+ 5
Assam ..	—65	29	18	—54
N. W. F. P. ..	..	10	6	..
Sind ..	..	21	13	..

According to the above table, three provinces, namely, Bengal, Bihar and Orissa and Assam, would be left with a deficit of 50, 31 and 54 lakhs of rupees respectively as shown in column 5. The Committee proposed that 50 lakhs should be remitted to Bengal, 33 to Bihar and Orissa and 18 to Assam and this sum of nearly a crore should be ratably borne by the other provinces in such a way that their surpluses should not be converted into deficits. This would enable every province except Assam to balance its budget and the position would then be as follows :—

Province	Contribution payable	Contribution proposed	Final surplus
Madras ..	1,15	1,41	22
Bombay ..	2,03	2,48	9
Bengal ..	2,55	2,05	..
U. P. ..	78	95	53
Punjab ..	57	70	51
Bihar and Orissa	68	25	2
Assam ..	18	..	-36

The Committee came to the following conclusions in this connection :—

“(1) 7½ crores is the amount required to carry out a logical distribution of income-tax among the provinces with special treatment only for the two provinces which are generally recognised to be in need of such treatment.

“(2) 6 crores would be sufficient to give special treatment to Bengal as well as to these two provinces; while leaving Madras, Bombay, the United Provinces and the Punjab each with a substantial surplus ranging from about 45 lakhs to about 70 lakhs.

“(3) On the basis of five crores, a method of distribution can be devised which, while calling for temporary sacrifices from these four provinces, would enable every province except Assam to balance its budget.

“On our estimated Federal surplus of 7 crores, a net distribution of five crores would leave 2 crores available for the contingencies to which we have referred. We can express no opinion as to whether this balance will prove more than sufficient to meet those contingencies, but we should hope that any new expenditure arising out of the establishment of the Federation, including the separation of Sind, will not exceed about one crore.”

INJUSTICE OF THESE CONTRIBUTIONS

There are four objections against these contributions. Firstly, as a comparison of the last columns of both the tables will show, Madras, Bombay, the U. P. and the Punjab have to suffer to the extent of 26, 45, 17 and 13 lakhs respectively to give benefit to Bengal, Bihar and Orissa and Assam; but the remaining provinces would not share this deficit. This is unfair to these four provinces. Secondly, these contributions are to continue indefinitely and though the Peel Committee had recommended that the constitution should specifically provide for the extinction of provincial contributions by annual

stages over a definite period such as ten or fifteen years, the Percy Committee could not anticipate any such period. Thirdly, it is noteworthy that the States were not to pay any such contributions and the report ignored the basic principle that Federal taxation should be borne equally by all units of the Federation including the Indian States. In spite of the difficulties facing the Indian States, it would not be fair on that account to expect British India to make any sacrifices in order to induce the States to join the Federation. Income-tax should be regarded as the legitimate property of the British Indian Provinces and the deficit caused by the restoration of the proceeds to those who paid the tax should not fall only on British India; but should be shared by all the Federating Units alike. These contributions cannot be justified on grounds of equity and a tax to which nothing is contributed by the Indian States cannot justly be regarded as a Federal tax. Fourthly, the revival of these contributions is undesirable as it would revive the old controversies.

NEW EXCISES

As the Federal Government would be left with a great deficit, the Committee proposed excise duties in order to obtain new sources of revenue. Regarding excise on tobacco, they expected a substantial revenue from vend licenses and fees, but an excise on it could not be relied upon in the near future to yield a substantial revenue. Such a duty could not be imposed on the cultivator and on the manufactured product it could not be successful when its manufacture continues to be so largely carried on in small establishments and even as a domestic industry and they regarded it unsafe to rely on it in the near future. Regarding excise on matches, they contemplated its existence from the outset of the Federation and anticipated an yield of about 3 crores with due allowance for reduced consumption, of which 2.50 crores would be raised in British India. This duty has now been imposed.² Other excises might occupy an important place in the fiscal policy of India in the future, but they could not rely upon the introduction of such measures in the early years of the Federation.

They also examined the case of augmenting the Federal revenues by a few selected monopolies. From a fiscal point of view they did not prefer the monopoly method of raising revenue to that of an excise duty and further, they did not think that the monopoly method could be applied with advantage in India to any new commodity. The manufacture of arms and explosives was already subject to license; while public utility monopolies stand on a different footing and

² See Chapter on *The Indian Budget*, 1934-35.

the monopoly from the only new commodity of broadcasting was regarded as problematical from the revenue point of view.

Commercial Stamps.—They did not recommend the federalising of commercial stamps in the near future as the loss of revenue to the different provinces would be unevenly distributed and their federalisation would not ease the problem of distributing income-tax. The difficulties in the way of separating stamp duties into two classes, commercial and non-commercial, would be grave and thus stamp duties were recommended to be provincialised. Further, in proposing that the proceeds of commercial stamps should be assigned to the Units, they were influenced by a doubt whether the problems arising from the imposition of Federal stamp duties in the States might not be disproportionate to the revenue involved.

PROVINCIAL SOURCES

For augmenting the provincial revenues the Committee suggested that the taxation of tobacco, otherwise than by excise on production or manufacture, should rest with the Units, with a right to the Federal Government to impose a general Federal excise. Succession duties were classed among taxes leviable by the Federal Government for the benefit of the Units though they were not prepared to rely on them as a source of revenue in the near future. Terminal taxes were also recommended to be imposed by the Federal Legislature for the benefit of the Units. Such terminal taxes as were in existence, mainly as municipal taxes, would fall into much the same category as other taxes classed as Federal, which, at the time of Federation, were being levied by certain Units. The municipalities and provinces were to continue to raise these taxes only within limits laid down by the Federal Legislature. The right to tax agricultural incomes was also recommended to be given to the provinces because of the close connection between this subject and land revenue. This right should be restricted to the taxation of income originating in the province concerned.

Regarding the general financial position of the provinces, the Committee pointed out that, on the basis of their existing revenues, most of the provinces would be in a difficult position at the outset of the Federation, even if they balanced their budgets in the intervening period and carry over into Federation only the liabilities which they had incurred. "If, during the intervening period, they continue to accumulate deficits year by year, the position will become quite unmanageable, and the prospects of real provincial autonomy will *pro tanto* be endangered. . . . If, . . . the provinces can be provided with a substantial addition to their revenues when the proceeds of income-tax begin to be distributed, it is of the utmost importance that they should make, during the intervening period,

the sacrifices necessary to enable them to take full advantage of the prospective improvement in their position. Otherwise the additional expenditure required to provide for the service of further loans, taken to cover deficits, may mortgage the new revenue to such an extent that in many cases provincial autonomy would start under the most unfavourable conditions."

"We regard it, therefore, as essential that the Government of India and the Local Governments should give this matter their immediate attention, and should endeavour to concert measures to secure equilibrium in the provinces during the intervening period." (Page 20 of the *Report*.)

Excise.—In this connection the Committee regarded the estimates on receipts from excise on country liquor as very low and they thought that the Provincial Governments were sacrificing revenue without effecting a corresponding restriction of consumption. According to them a province which deliberately sacrificed revenue had no right to ask for preferential treatment in the distribution of income-tax at the cost of other provinces.

Regarding expenditure, they did not take into account the possibility of economies other than those already adopted by Provincial Governments. Some further retrenchments might be possible within the framework of the existing administrative system; but they did not think it safe to assume that savings in that direction would do more than balance any increased expenditure directly due to the introduction of the new reforms.

EMERGENCY CONTRIBUTIONS

Emergency contributions were recommended to be levied for Federal purposes upon the Units on three possible bases—(1) the revenue of the Units; (2) their population; and (3) a formula based upon a scientific survey of their relative taxable capacity. The last was commended as the best; but in view of the absence of any scientific survey, the first one was regarded as the best solution after determining the revenue of each Unit on a comparable basis. Where it was not possible, the assessment might be made on a population basis, the amount of the total distribution being divided for this purpose in proportion to population between these Units and those accepting the revenue basis.

In case there was any permanent Federal surplus, the Peel Committee had recommended its distribution to the constituent Units and that the constitution itself should lay down the proportions in which funds thus available should be divided among the Units. The Percy Committee pointed out that the situation could not arise until any prescribed process of extinguishing Provincial or State contributions had

been completed. In that case the Committee suggested that the surplus should be distributed on a population basis as it would arise mainly from taxes on consumption. The Federal Government could, however, distribute any part of such a surplus for specific purposes on a basis determined by the Federal Legislature.

BORROWING POWERS OF THE PROVINCES

The Peel Committee reported that there must be a constitutional right in a province to raise loans in India upon the security of its own revenues; but the Percy Committee did not agree with this view and pointed out that so long as the security for the pre-Federation debt included the revenues of the provinces, the latter should be allowed to borrow with the consent of the Federal Government. As this procedure would be inconsistent with provincial autonomy, a middle course was suggested by them, based on the distinction between the general debt of the Federal Government and loans made to the Units by the Federal Government. They presumed that all the Units would have a right to apply to the Federal Government for loans, subject to the latter being satisfied regarding the security for such loans. The Provincial Loans Fund would then become a Federal Loans Fund. Then the Government of every Federal Unit should have the right of independent borrowing, provided the Federal Government was informed of this intention and an opportunity was given to offer advice. In case a Federal Unit had loans outstanding with the Federal Government, the former would raise a further loan only subject to the consent of the Federal Government.

An impartial and not a representative body of Loan Commissioners was recommended to be created to which the Federal Government could refer applications from Units for loans. Applications from Units having loans outstanding from the Federal Loans Fund for consent to independent borrowing should also be referred to these Commissioners. The decision on all applications should rest with the Federal Government.

In making the Federal forecast, the Percy Committee did not know the effect of a financial settlement between the States and the Federal Government, and the Davidson Committee pointed out that it would mean a burden of one crore upon the Federal resources. In that case the Federal surplus would be reduced to 6 crores. To compensate the deficiency in the $7\frac{1}{2}$ crores required to secure financial equilibrium in the provinces, the Government might rely upon the savings in military and civil expenditure.

It would be undesirable that the portion of income-tax proceeds to be distributed to the provinces should vary from year to year or be dependent upon the bounty of the Federal

Government. An automatic principle of division would be to assign the corporation tax to the Federal Government exclusively and fix a definite share of the rest of income-tax, excluding any tax on agricultural income. The Committee showed much ingenuity in elaborating their scheme regarding the distribution of the tax ; but the tests of simplicity, administrative convenience and intelligibility laid down by them can hardly stand scrutiny. It may be said that no system of contribution by the provinces is likely to be devised which will satisfy all the contributing Units ; while the growth of indirect taxes with the Federal Government might in the near future prove insufficient to restore equilibrium without income-tax.

If it is assumed that income-tax would remain a Federal source of revenue, it is futile to know the exact amount raised in every province to find out a basis for distribution. This is necessary only when it is treated as a provincial source of revenue. In public finance, taxation has no *quid pro quo* to the member paying it and it is as true of the Federal Government as of the local authorities. A combination of the population and revenue basis would be suitable. The population ratio would determine the needs of provinces ; while its combination with the ratio of the total revenue raised by each province to the total of British India would encourage responsibility and avoid improvidence.

The laying down of the principle of subventions to the weaker provinces is to be deprecated. It may be consistent with a spirit of mutual help and fraternity ; but it would also encourage applications from other Units and would increase the clamour for the constitution of new provinces. The correct solution, therefore, to deal with the case of weaker provinces is to grant temporary accommodation with a warning that they must develop their resources in course of time. The method of providing relief to the deficit provinces as a permanent measure is to be deprecated ; while even as a temporary measure, it is better to grant relief on the basis of a loan on favourable terms than by subventions.

It may also be said that the claim of Bengal to a share of the export duty on jute or of Assam to the excise duty on kerosene oil, etc., is wrong in principle and is inconsistent with the scheme of allocation of revenues between the Federal Centre and the Units. The recommendations of the Committee to empower the Federal Government to impose a surcharge for its own purposes on any tax levied by it for the benefit of the Units and to distribute its surpluses among the latter are likely to meet with approval.

The fact that the States would not be subject to any direct taxes even for emergencies, while the provinces would

have to bear some obligations is unfair to the latter. In cases of emergency they would like to make voluntary contributions to the Federal fisc instead of submitting to a levy of it by the authority of the Federal Government. This underlying unwillingness of the States to part with power is inconsistent with the essentials of Federalism. There can be no secure foundation for a constitution which depends upon the voluntary offers of any of its Units for dealing with grave emergencies.

Paragraphs 99 and 101 are unfair to British India in which the Committee recommend that British India should take its associates as they are and act upon the principle of maintaining the *status quo* in non-essentials as a better guide to policy than any ambitious ideals of equality or uniformity.

THE DAVIDSON COMMITTEE

The Davidson Committee were to examine the extent to which the existing financial relations of the Indian States with the Government of India and the Crown put obstacles in the attainment of an ideal system of Federal Government. Regarding the tributes or cash contributions paid by the States to British India, the Peel Committee had pointed out that contributions of a feudal nature were out of place under a Federal constitution and that only the probability of inadequate Federal resources at the outset prevented them from recommending their immediate abolition. The Davidson Committee, however, pointed out that the "feudal analogy is often very remote and affords no safe criterion for determining the legitimacy or otherwise of the claim for remission of tributes. Only some of these contributions such as those which represent the commutation of an obligation to render military service can properly be held to be of a feudal origin or nature. Many of them have no analogy to the feudal system as ordinarily understood, and others, paid under an agreement or treaty to the paramount power for military forces to be provided or for services to be rendered by the latter, are obviously in important respects in direct contrast to feudalism."

The Committee pointed out that contributions to Federal resources should be on a uniform basis and in the light of this principle, contributions made by the States whether in the form of a continuing cash payment or a past cession of territories, tributes and revenues stand on the same footing. The Committee recommended the cancellation of the assigned tributes even though the assignor State might not be willing in its turn to cancel the tributes as between itself and its debtor.

The Peel Committee recommended the remission of the excess of contribution of any State over five per cent. of its total revenues and this was endorsed by the Davidson Committee. This recommendation was to take place immediately.

With regard to the remainder of the cash contributions by the States, it was recommended that they should disappear *pari passu* with the contributions in the form of income-tax from the provinces to the Federal Government. With regard to ceded territories, the Committee opined that the net value at the date of the cession should be adopted as the criterion in making the financial adjustment.

It was also recommended that the cession of jurisdiction over railway lines for administrative purposes should not be exploited for fiscal purposes. In the case of civil stations in States, the area of foreign jurisdiction should be confined to the Residency itself and to the buildings under the control of the Resident. If any civil station is retained beyond these limits on political grounds, the conditions of the lease should be examined periodically. Under such circumstances, the State should have a right to the surplus revenues after meeting the administrative expenses of the locality.

Both the Davidson and the Peel Committees recognised that it would not be possible for the States to surrender internal land customs and thereby secure internal free trade in the Federal limits because of the importance of these duties as sources of revenues of the States. They recommended, however, the relaxation of the restrictions now existing upon the power of levying internal customs duties. Their conclusions regarding the claims of maritime States are sound ; while their view that a uniformity of burdens and benefits which should be the ideal of a Federal system would not be possible of achievement is in accordance with the views of the Percy Committee.

The net financial result of the recommendations of the Committee is to impose an additional burden of a crore of rupees annually upon the finances of the Federation which seems to be unfair to British India. It is true that no State can be compelled to join the Federation against its will ; but when once they think of joining it and do actually enter it, they must share its burdens and benefits.

The Committee held that Federation would be desirable even if their recommendations involved a substantial addition to the financial burdens of British India. It may be remarked that the transfer of responsibility at the centre was made conditional on the establishment of an All-India Federation. The Princes cannot of course be compelled to join the Federation against their will and as British India is eager to get responsibility at the centre, the States are probably asserting their rights with greater vigour than might be necessary. The ideal Federation would be achieved only if the States are prepared to make sacrifices *pari passu* with British India in financial and other matters just as has been done by Federal Units in other Federal systems.

CHAPTER XII

Recommendations of the Joint Parliamentary Committee

ACCORDING to the Joint Parliamentary Committee, the problem of the allocation of resources in all federations is one of great difficulty in view of the fact that two different authorities, each with independent powers, have to raise money from the same body of taxpayers. The problem can be simplified if separate fields of taxation are allocated to the two authorities. Even then the revenues resulting from this division may not fit the financial and economic requirements of each party. It is also true that these requirements do not necessarily continue to bear a constant relation to each other and it is, of course, extremely difficult to devise a variable allocation of resources. According to the Committee, in no Federal system has an entirely satisfactory system of the allocation of revenues been devised between the Federal authority and the Governments of the Units.

Under the existing system in India, the position from the point of view of expenditure is that the provinces have an unlimited field for the development of social services; while in normal times the demands upon the centre are more or less constant. The provinces have not had adequate means for a full development of social needs, "while the centre with taxation at a normal level, has no greater margin than is requisite in view of the vital necessity for maintaining unimpaired both the efficiency of the defence services and the credit of the Government of India, which rests fundamentally upon the credit of India as a whole, Centre and Provinces together." It should be pointed out that central resources in normal times are capable of expansion to a great extent.

The present depression has adversely affected both the Centre and the Provinces, whose financial position has been severely strained; while there has been an all-round increase in taxation. The Committee point out that in a few provinces the available sources of revenue are never likely to be sufficient to meet reasonable expenditure, and that the existing division of the heads of revenue leaves the Centre with an undue share of those heads which respond most readily to an improvement in economic conditions. For this reason the provinces demand a substantial share in the taxes on income.

The attitude of the States in the matter of direct taxation has given added impetus to the provincial claim for income-tax. If the income-tax is retained by the Federation

as by the Centre at present, it would be natural on the part of British Indian Provinces to insist that the subjects of the States also should pay income-tax, a part of which should be made available for the Federal fisc; but the States are not prepared for this arrangement.

The Federal Finance Committee in 1932 had recommended the plan evolved at the earlier sessions of the Round Table Conference to allot income-tax to Provinces and to meet the deficit at the Centre by provincial contributions, which would gradually be reduced over a prescribed period of years and would finally disappear with the development of new federal sources. The Committee could not, however, foresee their abolition in the near future. His Majesty's Government, therefore, abandoned this scheme.

The Joint Parliamentary Committee pointed out that the Provinces should, if practicable, share in the proceeds of the income-tax. The question then centres regarding the amount of this share. The Committee did not regard it possible to strike a theoretically correct balance between the States and British India, on the assumption that the States will not be subject to the federal income-tax. Many factors should be taken into account in this respect. There is the question of the pre-Federation debt whether it should not fall on British India alone, and expenditure like subsidies to the deficit provinces would be for British India purposes only. Further, a part of the income-tax proceeds is obtained from subjects of Indian States also, *e.g.* from the holders of Indian Government securities, etc. The States also make a contribution in kind to the defence of which there is no counterpart in British India. The Joint Committee therefore regarded it wiser to base the division upon the financial and economic needs of the Federation and the Units. They did not think the resulting disequilibrium to be of a serious character. The Federal Centre cannot, however, spare adequate fresh resources for the provinces for some time to come barring the needs of the deficit areas. But it is undesirable to leave the provinces with no indication of the share which they may ultimately expect when the existing difficulties become less severe. The Committee held that the transfer should be gradual to avoid dislocation of both Federal and provincial budgets.

According to the White Paper, taxes on income obtained from federal sources, *i.e.*, federal areas or emoluments of federal officers should be assigned to the Federation. Of the rest of the normal taxes on income except the corporation tax, a certain percentage was to be assigned to the provinces. This percentage was not to be less than 50 per cent. nor more than 75 per cent. Of this sum, the Federal Government would retain a certain amount. This latter amount was to remain

constant for three years and thereafter to be reduced to nil during the next seven years. The Federal Government and Legislature would, in addition, be empowered to impose a surcharge on taxes on income for federal purposes only. This power was to be exercised only in serious financial difficulties, when the States also would contribute to the Federal fisc.

The Joint Parliamentary Committee did not like the scheme, because any alteration in the rate of income-tax would affect both the Centre and the Provinces though only one of the parties might like to introduce a change. An alternative is to assign the yield of a given basic rate either to the Federation or the Provinces, the remainder going to the other; but this scheme would not fit well into the Indian income-tax system. The Joint Committee with slight modifications recommended the White Paper Scheme. The percentage to be ultimately attained should be fixed as late as possible by Order in Council; but the percentage of the rest of the normal taxes to be assigned to the Provinces is not expected to be higher than 50 per cent. It is not also possible to fix in advance a time table for the process of transfer. The actual periods referred to above in the White Paper proposal should preferably be left to be determined by Order in Council rather than be fixed by law. The proposal of the British Indian Delegation embodied in their Joint Memorandum that there should be an enquiry after three years did not find favour with the Joint Committee and was rejected. The actual method of distribution of income-tax between the various provinces was not recommended by the Committee; while the solution suggested by the Percy Committee for fixing an automatic basis of contribution was regarded as a useful line of approach to the problem. Beyond this, the Committee did not say anything in the matter.

CORPORATION TAX

According to the proposal of the White Paper the taxes on the income or capital of the companies were to be retained by the Federation and the tax was to be extended to the States after ten years, a right being reserved to any State which preferred that companies subject to the law of the State should not be directly taxed to pay to the Federal fisc an equivalent lump sum contribution. This desire of the States was appreciated by the Joint Committee though the details of the arrangement with the States seem to be complex and the adoption of the alternative procedure was regarded economically undesirable.

PROVINCIAL SURCHARGES

The White Paper proposed that a Provincial Legislature should be empowered to impose a surcharge not exceeding 12½ per cent. on the taxes levied on the personal income of persons

resident in the Province, and to retain the proceeds for its own purposes. The Joint Parliamentary Committee *did not favour this proposal* for three reasons. Firstly, it would lead to differential rates of tax on the inhabitants of different provinces, which is undesirable ; secondly, the rates of taxes on incomes are likely to be high enough to make it difficult to increase the rate by way of surcharge ; and thirdly, this power to the provinces would nullify the emergency power of the Federation of imposing a surcharge. The advantage of the proposal is that it would give a certain amount of elasticity to the provincial revenues, which would be desirable until the transfer of their share of the income-tax was completed.

TAXES ON AGRICULTURAL INCOMES

In this respect the White Paper proposal giving the provinces exclusive power to impose taxes on agricultural incomes not subject to income-tax at present was approved by the Committee.

THE DEFICIT PROVINCES

Sind, Orissa, Assam and the North-West Frontier Province are provinces with deficits for which the Centre is to make contributions to enable them to balance their budgets. Sind is not expected to be permanently a deficit province ; while in the case of Orissa and Assam there is no likelihood that revenue and expenditure would balance under any scheme of allocation of resources, present or proposed. According to Proposal 144 of the White Paper, a fixed subvention would be granted to such provinces from the Federal revenues. This contribution is to be made a permanent and stable contribution to avoid the danger that the province concerned may be tempted to rely on expectations of extended federal assistance and may not thus develop its own resources. The scheme was agreed to by the Joint Committee. The proposal was that the Provinces to be assisted and the amounts of the subvention should be determined after further expert enquiry which was conducted by Sir Otto Niemeyer. At present the North-West Frontier Province is receiving a contribution of 75 lakhs of rupees annually from the Centre, which is to continue ; but the Federal Centre was recommended to have power to review the amount from time to time.

EXCISE AND EXPORT DUTIES

In this connection the White Paper Proposal contained in Paragraph 137 was to empower the Federal Legislature to assign to Provinces and to States the whole or a part of the net revenues obtained from salt, federal excises and export duties under a scheme of distribution as the Federal Legislature might

determine. In the case of export duties on jute and jute products, at least 50 per cent. of the net revenue from the duty is to be compulsorily assigned to the producing Units. The object of the provision in relation to salt duties and excises is to make the financial scheme more elastic in the interest of future development, and it might facilitate the introduction of a new tax. The Joint Committee endorsed this proposal. In regard to the proposal relating to the assignment of 50 per cent. of the revenue from jute export duty to Bengal, the Committee held that the special circumstances of the province justified this special treatment. They did not, however, express an opinion in relation to a share in the proceeds of the excise duty on petroleum for the benefit of Assam.

TERMINAL AND OTHER TAXES

Proposal 138 of the White Paper lays down that the power to impose certain terminal and other taxes should be vested solely in the Federation, though the proceeds would be distributed to the provinces; but the Federation would have a right to impose a surcharge for federal purposes. Such cases relate to the following items:—

- (1) Duties on property other than land passing on death;
- (2) Taxes on mineral rights and on personal capital (other than land);
- (3) Terminal taxes on railway, water or air-borne goods and passengers, and taxes on railway tickets and goods freight;
- (4) Stamp duties which are the subject of legislation by the Indian Legislature at the date of Federation; and
- (5) Taxes on income other than on agricultural income barring taxes on the income of companies.

This proposal was endorsed by the Committee because of the necessity of securing uniformity in the rate of the tax or its administration.

INTEREST OF THE UNITS IN THE FEDERAL BUDGET

The Federal Units may share in the yield from certain federal taxes. This means that the Federal Budget cannot be the concern of the Federal Government and Legislature alone. In order to promote mutual consultation between the Federation and the Units in such cases, Proposal 140 of the White Paper lays down that Federal legislation upon them should require the prior assent of the Governor-General. This should be given after consultation with both the Federal Ministry and the Governments of the Units. According to the Joint Committee this statutory obligation to consult the Units might cause difficulties. It was, therefore, recommended that there should be directions to the Governor-General in his Instrument of Instructions to ascertain the view of the Units in the manner

that he thought best under the circumstances. The suggestion to create a special Provincial Fund to which all receipts in aid of Provincial revenues should go, to be administered for the benefit of the Provinces by the Governor-General on the advice of a statutory Inter-Provincial Council representing the Provincial Governments, was not favoured by the Committee.

FINANCIAL ADJUSTMENTS BETWEEN THE FEDERATION AND THE STATES

The principles underlying the recommendations of the Davidson Committee in general were endorsed by the Committee. Any contribution paid by a State to the Crown which was in excess of the value of the immunities which it enjoyed was recommended to be abolished gradually over a period of years, corresponding to the period during which it was proposed to defer the full assignment to the Provinces of a share of the taxes on income.

LAND CUSTOMS DUTIES IMPOSED BY STATES

Many States derive substantial revenues from customs duties levied on their frontiers on goods which enter the States from other parts of India. These duties are called as internal customs duties, but in the cases of the smaller states they correspond to octroi and terminal taxes more than to customs. In the case of the larger states the right to impose them is limited by treaty. Internal customs barriers are inconsistent with the freedom of interchange of a fully developed Federation and the Joint Committee were of the opinion that every effort should be made to substitute other forms of taxation for these internal customs duties. The change should be left to the discretion of the States concerned as alternative sources of revenue become available. The Committee thought that the accession of a State to the Federation should imply its acceptance of the principle that it would not set up a formidable barrier to internal free trade which might jeopardise the future of the Federation. The Committee, therefore, endorsed Proposal 129 of the White Paper which empowered the Governor-General *in his discretion* to instruct a member-State of the Federation to secure the fulfilment of the federal obligations.

STATES' MARITIME CUSTOMS

The Committee favoured the principle that the maritime States which levy sea customs duties should be allowed to retain only so much of the customs duties collected by them as was properly attributable to dutiable goods consumed in their own territory. If the treaty rights stood in the way of the attainment of this ideal and if the same were insisted upon, the Committee held that the question would have to be seriously

considered whether the State could be admitted to the Federal system. It is thus important to secure a genuine uniformity in the rates of customs duties levied at State ports and at the ports of British India respectively.

BORROWING POWERS

The provisions with regard to borrowing powers are contained in Paragraphs 146–149 of the White Paper. The Federal Government will have power to borrow for federal purposes upon the security of federal revenues within limits fixed by Federal Law. The trustee status of existing India sterling loans will be maintained and extended to future sterling federal loans.

The Federal Government will have the power to grant loans to or to guarantee loans of the Federal Units on terms and conditions to be prescribed by it. The Government of a Governor's Province will be empowered to borrow for provincial purposes on the security of provincial revenues within limits which may be laid down from time to time by provincial law. In case the loan granted or guaranteed by the Federal Government is outstanding or the loan is to be raised outside India, the consent of the Federal Government will be required.

The Joint Committee accepted these proposals subject to one modification that when the loan guaranteed or granted by the Federal Government was outstanding or the loan was raised outside India by a Federal Unit, the ultimate decision whether consent had been unreasonably withheld by the Federal Government should rest with the Governor-General in his discretion. The Federal Ministry might like to control the general policy of a province by refusing the application or by insisting upon unreasonable conditions. The Committee, therefore, suggested the modification mentioned above.

ADDITIONAL EXPENDITURE

The additional cost of the scheme as given in the *Report of the Joint Parliamentary Committee* may be summarised below :—

Item	Cost per annum Rupees
Overhead charges for provincial autonomy	.. 3 ¼ crore
Overhead charges for Federation	.. 3 ¼ crore
Separation of Burma	.. 3 crores
Subvention to Sind	.. 3 ¼ crore
Subvention to Orissa	.. 30 lakhs
Financial adjustments with States	.. 1 crore
Subvention to N. W. F. P.	.. 75 lakhs

The total annual additional cost would thus come to seven crores and thirty lakhs of rupees and taking into consideration

the subvention to other deficit provinces, it might come to about eight crores of rupees annually. The Committee, however, argued that the additional expenditure due to the separation of Sind and Orissa would come to 10 and 25 lakhs respectively which is already included in the overhead charges referred to above and that the remaining expenditure would have to be found somehow even if these provinces were not created into separate units. The case of Assam for an increase in its revenues has been recognised for some time and the subvention to the North-West Frontier Province has already been granted. Then the additional cost would come to about 5½ crores of rupees annually.

The Committee conclude that the proposed constitutional changes would not directly involve any new formidable financial burdens upon the tax-payers of India as a whole, but "the necessity for giving greater elasticity to provincial resources, the subventions to the deficit Provinces, and also the separation of Burma, will impose a further strain on the finances at the Centre."

It is suggested in Paragraph 60 of the White Paper that at the last possible date there should be a financial enquiry and the Committee endorsed this suggestion. They pointed out that no expert body could say that the new constitution would not aggravate the financial difficulties to a dangerous extent. In this connection they held that Parliament must receive direct assurance from His Majesty's Government at the appropriate time. Sir Otto Niemeyer made the enquiry and issued his report.

CRITICISM

The above recommendations of the Joint Parliamentary Committee have been embodied in the Government of India Act, 1935. The scheme of the division of financial resources between the Federal Centre and the Units does not seem to be fair to the British Indian Provinces and it is open to the following objections :—

Firstly, the constitutional advance is to involve an additional expense of about seven crores of rupees which the Indian tax-payer cannot bear without curtailing the most vital necessities of life. The average *per capita* income in India is very low and the possibility of an additional tax thereon cannot certainly be contemplated with equanimity. The masses are groaning at present under a system of top-heavy and costly administration, and any constitutional advance which does not promise a reduction in taxation cannot be in the best interests of the Indian masses.

Secondly, the creation of separate new provinces is altogether uncalled for and unnecessary. This would involve additional charges which could have been easily avoided. For

a long time to come Sind cannot be a self-supporting province and the findings of the Sind Financial Enquiry Committee were ably questioned by the late Prof. Chabiani and in the face of these facts, the constitution of Sind into a separate province is altogether unjustifiable. The separation of Burma and also the constitution of Orissa into a separate province should not have been done.

Thirdly, the system of subventions to the deficit provinces is unjustifiable on economic grounds. It is at the cost of the general tax-payer. A better alternative would have been to grant loans to the deficit provinces guaranteed by the Centre to give the advantage of low rates of interest to the former. These loans would have been repaid according to a scheme formulated in advance. This would have put a check upon the extravagant demands for the creation of new provinces which could not be self-supporting.

Fourthly, the provisions regarding the raising of loans by the provinces are that if they borrow money outside India or if the loan granted or guaranteed by the Federal Government is outstanding and further loans are required, the decision for allowing to borrow an additional sum would rest with the *Governor-General in his discretion*. The decision should have been with the Federal Legislature and not with the Governor-General *in his discretion*.

Fifthly, the provisions regarding the customs duties imposed by the States entering the Federation are unsatisfactory. They would prevent a uniformity in the rates of customs duties levied at State ports and at the ports of British India. This would divert trade from the British Indian ports to the State ports to a great extent. Land customs duties imposed by States would impede internal trade of the country and would consequently put a check upon industrial development. The possibility of alternative sources of taxation like the income-tax should have been seriously considered.

Sixthly, the assignment of 50 per cent. of the jute export duty to Bengal is unjustifiable on financial and economic grounds. The principle of equity also does not sanction it. If this principle of assignment is granted, then customs import duties should go to the provinces where the ports are situated and excise duties should go to those provinces where the revenue is raised. This principle cuts at the root of uniformity and co-operation and is bound to create inter-provincial jealousies.

Finally, the British Indian Provinces and the Indian States entering the Federation should bear the burden of the constitutional changes in adequate proportion; but it is not so according to the provisions of the Government of India Act, 1935. Almost all the additional expense is to fall on the British Indian Provinces. A portion of the income-tax is to be retained

by the Federation ; but there would be no direct taxes in the States subject to the control of the Federal Centre and this involves injustice to the British Indian Provinces.

The States which like to come into the Federation must be prepared to share the common burdens to be imposed upon the Federating Units ; because as members of the Federation they would enjoy common privileges. As the provisions stand, this is not the case. Moreover, the additional burden of about seven crores of rupees would make it still more difficult for the provinces to pursue the nation-building activities on an adequate scale.

The progressive Ministry in a province would not be able to finance provincial schemes of economic development in an unfettered manner ; because in some cases further borrowing would depend upon the Governor-General *in his discretion*. The sanction of the Federal Ministry should have been quite enough under the circumstances.

CHAPTER XIII

Sir Otto Niemeyer's Report

THE further constitutional advance of the country was made dependent upon a satisfactory financial position of the Provinces and the Centre, and accordingly, Sir Otto Niemeyer was deputed to make this investigation. According to his findings, the budgetary prospects of India, if given a prudent management of her finances, justify the view that adequate arrangements can be made step by step to meet the financial implications of the new constitution. After dealing with the financial position of the Provinces and the Centre, he has proposed assistance for eight out of the eleven provinces, which will cost the Centre about two crores of rupees annually. According to him, "His Majesty's Government may safely propose to Parliament that Part Three of the Government of India Act of 1935 should be brought into operation a year hence."

Further, income-tax amounting to six crores of rupees assignable to the provinces will be retained by the Centre for the first five years, unless the railways are able to make a substantial contribution. The Centre should begin relinquishing it gradually during the second five years, so that within ten years of provincial autonomy, the provinces may hope to enjoy full share from this revenue head.

He started on the assumption that at the inauguration of provincial autonomy each of the provinces should be so equipped that it may enjoy a reasonable prospect of maintaining financial equilibrium and that the chronic state of deficit into which some of them have fallen should come to an end. His object was, therefore, to examine the existing and prospective position of the provinces in matters of finance and to determine the extent to which special assistance would be needed for that end. He also considered how far the Central Government would be able to render such assistance without jeopardising its own solvency. He also suggested to what extent and when it may be possible for the Centre to place additional resources at the disposal of the provinces out of the proceeds of taxes on income. From the provincial point of view, it is desirable to attain this end ; but the question is to determine an equitable basis of distribution from the central point of view. He also laid emphasis on the paramount consideration of maintaining the financial stability and credit of India as a whole.

According to him, expenditure on the Centre cannot be further reduced consistently with safety. Provincial expenditure could be advantageously increased as the provinces are in charge of nation-building departments like sanitation, education, public health, agriculture, etc. In his opinion, some expansion may now be anticipated from the recovery of provincial revenues not all of which are, or need be, static. But the main hope of the provinces for future expansion lies in the allocation at an early date of a share in taxes on income under Section 138 of the Government of India Act, 1935.

Regarding the existing position of provincial budgets, he remarks that no settlement can ensure freedom from the ordinary risk of a casual budgetary deficit to a province, whatever the course of its administration may be. He further observes that special assistance to certain provinces can only be given at the cost of the central revenues in whatever form it may be. Further, it must operate to delay *pro tanto* the general transfer to all provinces of their share of taxes on income. "This consideration cannot be absent from the mind of anyone endeavouring to deal fairly with the whole problem and sets one a limit to the amount of prior readjustment which can reasonably be admitted. At the same time it is equally clear that some provinces are intrinsically better off than others and at the moment less urgently in need of additional resources, and it is both fair and inevitable that a certain measure of correction should be applied even if it means that the provinces which have been able to attain higher standards of administration should now to some slight extent have to progress more slowly."

The United Provinces are to get Rs. 25 lakhs per annum for the next five years and it is pointed out that while the ultimate future of the Province gives less cause for anxiety, its immediate difficulties are considerable. It is recommended that Sind subvention should remain at Rs. 105 lakhs for a period of ten years and should then be reduced by stages after ten years. At the end of ten years it should diminish by 25 lakhs a year for twenty years, by 40 lakhs a year for the next five years, by 45 lakhs a year for the next succeeding five years and thereafter until the whole barrage debt is repaid by 50 lakhs a year. When the debt has been repaid in about forty years from funding in 1942, any remaining portion of the subvention will in any event cease. For Orissa an annual help of approximately Rs. 50 lakhs is recommended, and further grant is to be made by the Government of India to the Orissa Famine Fund so as to raise the total in the latter to the figure of 10 lakhs and for this purpose a further non-recurrent sum of Rs. 4 lakhs would be needed in view of the fact that Rs. 5 lakhs have already been provided for this purpose and a contribution of Rs. 1½ lakhs is

included in the Orissa budget for 1936-37. Further, the provision in the Government of India Budget 1936-37 towards the cost of the buildings for the headquarters of the Province, amounting to Rs. 27½ lakhs is regarded as insufficient, and a further sum of Rs. 15 lakhs at the rate of Rs. 3 lakhs per annum in each of the first five years is recommended. Thus the total help recommended to be given to Orissa comes to about Rs. 57 lakhs in the first year, Rs. 53 lakhs a year in the next four years and thereafter Rs. 50 lakhs a year.

The measure of the assistance for Assam is to depend partly on the prospective revenue of the Province, allowing for a moderate amount of continued recovery, and partly on the degree to which the existing provincial deficit, about Rs. 47 lakhs in 1935-36, can be regarded as having been unavoidable. Allowance has further to be made for the cost of provincial autonomy and for certain adjustments of expenditure with the Centre, including the cost of Assam Rifles, hitherto mainly borne by the Central Government. Thus Assam is to get Rs. 45 lakhs annually, and in addition, the proposal of the Central Government to bear Rs. 7 lakhs of the cost of the remaining Assam forces is endorsed as an equitable arrangement by Sir Otto Niemeyer. In view of this assistance, he does not endorse the special claim of the Assam Government in connection with the proceeds of the excise duty on Assam oil.

Since 1932 the North-West Frontier Province has been receiving an annual subvention of rupees one crore and Sir Otto has recommended that this annual subsidy of one crore should be supplemented by approximately Rs. 10 lakhs per annum and it should be fixed for a period of five years after which it should be subject to revision in the light of the then existing circumstances. By revision, he does not mean an increase, but a mere review of the position is contemplated in the light of five years' further financial administration.

The separation of Burma would involve a net loss to central revenues, amounting to about 2½ crores of rupees. These two items together would clearly present a budgetary problem of some magnitude, if they had to be faced at one blow in 1937-38. But according to Sir Otto they need present no special difficulty in view of the possibility of expansion in central resources, which he anticipates with confidence. Owing to the Reserve Fund of about Rs. 2 crores, constituted out of the anticipated surplus of the year 1935-36, he does not see any reason why the grant of these additional resources to the provinces should not commence in 1937-38. He further remarks that the scope in the next five years for relaxation of revenue burdens is likely to be extremely small unless economic improvement takes place at a rate well in excess of what can now safely be assumed.

JUTE EXPORT DUTY

Sir Otto does not agree with the argument that the incidence of the jute export duty falls wholly on the producer, because no statistical proof of this contention has been produced. Even if it could be produced for a specific date, it would not hold good in all circumstances of a changing market. Further, no source of revenue can in any country be derived equally from all parts of the country alike, rich and poor, industrial and agricultural. He, therefore, concludes that in so far as a claim may be put forward on the ground that the taxable capacity of Bengal is limited by the incidence of this duty, that is a claim not so much to this particular duty as to the financial assistance generally. It is part in fact of the case for a share in taxes on income or for such prior special treatment as it is the object of his recommendations to ensure.

It may be said that his conclusion in this respect is economically sound. *A tax by its very definition is a compulsory contribution levied upon the members of a state without involving any QUID PRO QUO.* Bengal or for the matter of that no province can have a special claim for an exclusive allotment of the proceeds of a tax raised within its borders. Further, whatever validity there may be in the argument has already been met by the surrender to the provinces concerned of 50 per cent. of the net produce of the duty. But Sir Otto has recommended that the percentage should be increased to 62½ per cent. on the estimated gross yield of the duty in 1936-37 at Rs. 380 lakhs. This would mean in round figures the following additions to the resources of the provinces concerned at a corresponding cost to the Central Government: Bengal Rs. 42 lakhs, Bihar Rs. 2½ lakhs, Assam Rs. 2¼ lakhs, Orissa rather over Rs. ¼ lakh.

It may be mentioned at this stage that the United Provinces have not been given that consideration which is their due. The Government have resorted to special taxation measures and to retrenchment and still there is a deficit budget which does not augur well for the future of the Province. In the matter of literacy our province is far behind others and there is a great scope and necessity too, for an expansion of the nation-building departments, if prosperity is to be secured for the people. Thus the U. P. deserves more help than has been recommended to the Province.

He further makes two observations in connection with taxation measures. He says, "I wish to add two comments on these recommendations. After the abolition of tax on the smaller incomes and the two successive reductions in the rates imposed in 1931 the rates of income-tax and super-tax in India, especially on the higher incomes, are by no means excessive.

The general scheme of Indian taxation (Central and Provincial) operates to relieve the wealthier commercial classes to an extent which is unusual in taxation schemes and there would be no justifiable ground of complaint if a slight correction of this anomaly were maintained. The assignment of taxes on income is the main method of assisting provincial finances contemplated by the Government of India Act and, if the remaining surcharge were maintained, it would materially contribute to the early receipt by the provinces of additional resources."

POSITION OF RAILWAYS

The early establishment of effective co-ordination between the various modes of transport and the thoroughgoing overhaul of railway expenditure in itself are considered to be the vital elements in the whole provincial problem. Each province advocates the basis of a division, population, residence etc., which gives it the largest net dividend. Sir Otto does not regard any of the proposed bases as having any particular scientific validity. They do not satisfy in any appreciable degree the ideal, but practically unascertainable, test of the capacity to pay. The mere accident of place of collection is an unsuitable guide. The residence of the individual too, though it may be a convenient dividing line for avoiding double taxation between separate political units, is not in itself a very scientific criterion, particularly in a Federation. Finally, even supposing it were practicable to ascertain to what part of India particular fractions of income, and therefore the incidence of the taxation burden properly adhere, it is still arguable that in a Federation other considerations also are involved, particularly if the benefits and incidence of other forms of common taxation are unequally divided as between the various partners.

It may thus be said that three forms of assistance to the provinces have been suggested: cash subventions, debt cancellation and the distribution of further 12½ per cent. of the jute tax. In the cases of Bengal, Bihar, Assam, the N. W. F. P. and Orissa, the entire net debt is to be cancelled; while in the case of the C. P. all pre-1936 deficit debt, *plus* approximately Rs. 2 crores of the pre-1921 debt is to be cancelled. Cash subventions have been recommended for all provinces except for Madras, Bombay and the Punjab. The reason given is that Madras benefits immediately to the extent of Rs. 20 lakhs through the separation of Ganjam district, and Bombay likewise benefits to the extent of Rs. 90 lakhs through the separation of Sind, and on the merits of the case the Punjab benefited long ago when its deficit districts of the frontier were constituted into a separate province. On merits, Sir Otto does not uphold

the claim of Bengal to the whole of the jute export duty and proposes the enhancement of Bengal's share merely as a most convenient method of giving relief.

His findings are based on the consideration "that the expenditure at the Centre cannot be expected consistently with safety to decrease much below the point to which it has now been reduced". This has, however, been the pivotal point of dispute and Indian businessmen and economists have laid emphasis on a proper rationalisation of the central expenditure with a view to reduce same on items like the Army, the Civil Services, etc., so that the same may be in keeping with the economic standards of the people of the country, consistently with efficiency.

A thorough overhauling of railway expenditure too has been recommended as a vital element in the whole provincial problem. He does not suggest any increase in the railway rates and fares. Indeed, the railway finances appear to be the crux of the problem in determining the speed of relief to the provinces. Taking the worst view, if the railways are unable to meet the deficit out of their own reserves and have to be subsidised from the Central Budget, the entire financial structure of the new constitution is liable to be completely upset. If the railways are able to pay their way, the Niemeyer scheme of help to the provinces would stand; otherwise the proposed devolution of income-tax share to the provinces during the second five-year period may have to be interrupted by the Governor-General suspending the operation of the scheme owing to fall in other revenues not made good by contributions from the railways.

The Report suggests the retention of the remaining surcharge on income and super-tax as a permanent feature of taxation system in the country. An increase in or a high level of taxation is in itself absolutely no indication of its burden on production and distribution. The distribution of the burden of taxation would depend upon the ways of spending the revenue. If they are spent on nation-building departments and if they provide increased opportunities of employment to people, they are economically justifiable; otherwise perhaps they are not. According to Prof. Marshall, "a slight and temporary check to the accumulation of material wealth need not necessarily be an evil even from economic point of view, if, being made quietly and without disturbance, it provided better opportunities for the great mass of the people, increased their efficiency and developed in them such habits of self-respect as to result in the growth of a much better race of producers in the next generation." Judged from this test, the high level of taxation would be very burdensome to the businessmen and producers. There

is to be no relief in the military and civil expenditure and the new constitution would not confer any economic advantages upon the masses. Provincial and Federal Ministers, perhaps, would not be in a position to formulate schemes of economic development as they would not have a free scope to do so. Under such circumstances, economists and businessmen cannot afford to be enthusiastic over the retention of the existing high level of taxation.

CHAPTER XIV

Indian Public Debt

THE subject of our external obligations is of special significance for two reasons. Firstly, it is very closely connected with India's economic position and has an important bearing upon her future economic development. Considerations of national economic autonomy require that the nation should have no external obligations which may act as a dead weight on its economic progress. Secondly, the future constitution of the country should be based upon a just and workable understanding regarding foreign obligations. India will redeem every pie of her foreign obligations and repudiation is absolutely out of the question; but what is necessary is that there should be a fair and equitable settlement of these debts just to see if any items have been wrongly debited to the Indian Exchequer. A settlement of these questions will necessitate the devising of ways and means for meeting these obligations.

Our external obligations may be divided into four sections: firstly, debts which India owes to foreigners on account of government borrowings; secondly, Home Charges, represented by interest on foreign loans and expenditure on account of the civil and military services; thirdly, debts of semi-public bodies like the municipal and port trust authorities; and fourthly, India's liabilities on account of foreign commercial investments in the country.

The burden of these various obligations on India, on her revenues and consequently on her economic conditions is very great. When the balance of trade is unfavourable to India, these obligations have to be met by borrowing money. This state of affairs is detrimental to the economic stability of the country and it points to the imperative necessity of reducing the burden of these obligations.

The nature and origin of our public debt may now be examined with a view to find out its bearing on the economic position of our country and to suggest measures how best these obligations can be redeemed so that they may not entail a heavy burden.

These debts originated with the East India Company, who borrowed money whenever the revenues were insufficient to meet their demands. The Company's debt stood at £7 million in 1792; but it had risen to nearly 60 million pounds just before the Mutiny because of Wars and conquests. The Mutiny was responsible for raising the debt still higher, and the whole cost of suppressing it was borne by India, so that by 1860 the public debt stood at £100 million. When the Crown took over the Government of the country in 1858 from

the Company, the former also assumed the responsibility of the whole of the debt of the Company and also paid £12 million for the capital stock of the East India Company. War, famine and exchange were responsible for augmenting the public debt of India between 1860 and 1900.

From the year 1860 there has been a steady increase in India's productive or public works debt, because the Government adopted the policy of borrowing for constructing productive works like railways and irrigation works. The interest on Public Works Debt was charged to a separate Railway and Irrigation Account, and the interest on the ordinary debt (as the unproductive debt began to be described after 1870) was charged under the general heading of debt. The Public Works Debt increased when the Government had to borrow for purchasing some of the railways from the Companies or for making advances to them for capital account.

The total public debt of India stood at 510 crores in 1914, but it rose to 1136 crores in 1930. The following table shows the position in this connection¹ :—

	31st March 1929	31st March 1930	31st March 1931
Total in India	602.71	648.28	651.78
Total in England	353.81	366.15	387.76
At 1s. 6d. per rupee	471.75	488.20	518.12
Total interest-bearing obligations	1,074.46	1,136.50	1,169.90
	31st March 1932	31st March 1933	31st March 1934
Total in India	707.18	706.18	700.78
Total in England	379.84	379.02	383.70
At 1s. 6d. per rupee	506.45	505.36	511.60
Total interest-bearing obligations	1,213.63	1,211.84	1,212.38

CAUSES OF INCREASE

The sterling debt of the Government of India was about £120 million in 1900, and £247 million in 1914 ; while it grew

¹ *The Indian Year-Book*, 1934-35, pp. 871-872.

up to £363 million by 1930 and to £383·70 by 1934. The increase in the debt in this century has been due to the construction of new or the purchase of old State Guaranteed Railways. The Mackay Committee of 1907 recommended that £12½ million should be spent annually on railway construction; whereas before that the Government of India had never borrowed more than £3 million in any year. The result was that heavier loans were raised during the three years 1907–1910 at a higher rate of interest. During the nine years from 1921–22 to 1929–30, no less than £93½ million worth of open market loans were raised in London; but this does not completely explain the heavy post-War sterling borrowings. In 1924 and 1925 respectively the State took over the management of the E. I. R. and the G. I. P. which added £22 million to the Indian debt on account of the debenture liabilities of these companies.

The Government's sterling obligations have also increased on account of book debits made in respect of railway annuities. In accordance with the undertaking of the Government to buy out certain Company-owned railways, the purchase price of these lines has been distributed over a period of years in annual instalments. The actual appearance of the liability as a sterling liability began from 1924–25; although it was in existence a long time before its actual appearance.

The War was also responsible for increasing our foreign obligations to the extent of £100 million, which was a gift made by India to Britain for the prosecution of the War.

There are external rupee obligations also. Rupee loans are not necessarily internal obligations. They are called rupee loans merely because they are raised in India in rupees and the interest and principal are payable in rupees. It cannot be supposed that they are held exclusively by Indians. Some portion of these loans is held by British investors who live in England and to whom interest has to be remitted. This could have been excluded from consideration if a corresponding amount of our sterling obligations had been held by Indians, which is not the case.

Another important feature of India's post-War sterling borrowings has been the high rates of interest paid in many cases. They were even higher than those offered for rupee loans in India during the same years. In 1921–22, the £7½ million loan was issued at par at 7 per cent.; whereas in India in the same year 49 crores were borrowed at par at 6 per cent. A major portion of the post-War sterling loans was raised on higher terms than those offered in India for rupee loans. During this period India had become a much cheaper market than London for raising loans for the Government of India. The difference in the interest rates would be still wider if we

consider the fact that while the interest paid on sterling debt held in England is exempt from Indian income-tax, the interest on rupee loans is liable to it.

In addition to these capital obligations, India has also current obligations, some of which are due to capital obligations. The Home Charges include interest on our productive debts, on unproductive debts, and payments for services, civil and military, which India has accepted. These charges have also increased from Rs. 30.46 crores in 1913-14 to the maximum of Rs. 46.52 crores in 1922-23. They declined to Rs. 36.87 crores in 1925-26 to mark a further rise thereafter; while in 1932-33 they amounted to £35.3 million, or nearly 44 crores of rupees. The existence of these charges implies the existence of the dead weight debt on our revenues.

A small part of India's sterling obligations consists of loans raised by the Municipal Corporations of the Presidency towns and Port Trusts. The total amount of these obligations was £13 million in 1929.

FOREIGN PRIVATE INDUSTRIAL INVESTMENTS IN INDIA

Reliable figures relating to the estimates of foreign private investments in India are not available and they are thus necessarily approximate. At the end of the year 1929-30 the total foreign industrial and commercial investments were valued at £740 million. This amount represents the paid-up capital of joint-stock companies registered outside India but working here. This figure is evidently wrong if the entire paid-up capital of these companies has been considered as invested in India, because it is not employed in India in its entirety. The capital of companies registered elsewhere but working exclusively in India may be taken as invested in India though in their cases also, a portion must be employed at the Head Office. Then there is the case of companies with huge paid-up capital whose operations in India form only a small part of their activities, *e.g.*, a concern like the Imperial Chemical Industries. Evidently, it would be wrong to include its entire paid-up capital in the figures of foreign investments in India or any part of it except what is employed in its Indian business. As these concerns are not required by law to frame a separate balance-sheet of Indian business, it is difficult to understand how the figures given in the Statistical Abstract have been arrived at.

On the other hand, the paid-up capital of foreign concerns, working exclusively in India, may not represent the total amount of capital employed by them. A part of their Indian investments may have been raised as loans and if they are not included in the figures of investments, our foreign obligations have to that extent been under-rated. Further, a part of the

capital of foreign companies may be held by Indians and non-Indians may have large interests in Indian companies as in the case of jute mills, tea and cement concerns.

Thus there is the inadequacy of statistics and it is necessary that we must have more accurate and comprehensive figures. The Government should devote particular attention to the correct estimate of India's foreign obligations of every class, and a separate section of their Annual Statistical Abstract should be devoted to the subject. To have a correct estimate of the amount of foreign capital invested in India, foreign concerns working in the country should be obliged to submit returns in a prescribed form, furnishing all the necessary information. This should apply to all foreign concerns, whether individual, partnership or joint-stock. Such returns are obligatory in many other foreign countries and, therefore, this obligation would not be unusual.

In their economic implications these foreign commercial investments in India stand on a somewhat different footing as compared with our national debt. Firstly, we have not to pay any fixed interest on them and if they have earned a profit, it will be remitted abroad. Thus they do not represent a fixed charge upon this country unlike the debt obligations of the Government. Secondly, in times of depression when it is difficult for the Government to meet her fixed foreign obligations, the burden of these variable obligations correspondingly diminishes. In such times, these investments may even be sold out and transferred to more profitable fields abroad. But they are an important obligation, and the transfer of the original amounts and their profits exert a strong influence upon exchange.

The total annual charges on our total foreign obligations come to Rs. 100 crores and it is thus necessary that India should have a constant visible balance of trade at least large enough to meet them, failing which she would have to export gold or borrow more in foreign markets. The following table shows the actual position of our trade²:—

				Rs.
1925-26	..	..	..	109·00 crores
1927-28	..	..	..	49·78 crores
1928-29	..	..	..	52·11 crores
1929-30	..	..	..	52·78 crores
1930-31	..	..	..	37·62 crores
1931-32	..	..	..	90·48 crores
1932-33	..	..	..	68·00 crores

² *The Indian Year-Book*, 1934-35, p. 911; also see N. R. Sarker, *The External Obligations of India*, p. 11.

These figures, barring those of 1925-26, show that India is unable to meet her recurring annual obligations without drawing upon her gold resources. From the financial point of view the country has not been paying her way. This is indeed a grave state of affairs, for, if we are unable to meet our recurring annual obligations, the possibility of reducing our foreign capital obligations may be impossible of achievement without deliberate efforts either to increase our trade balance or to reduce progressively our foreign commitments.

THEIR INCIDENCE AND EFFECTS

✓ The effects of these obligations may now be considered. The most direct and immediate effect is upon the Budget and upon the finances of the Government. Interest payments and other charges are to be met out of our revenues and their burden is fairly heavy. In 1932-33, a sum of forty-four crores of rupees was required to meet the expenses connected with these obligations. It means that about one-third of our revenues is required to meet the foreign interest payments, pensions, etc. It is true that a large part of it is interest on capital raised abroad for more or less productive purposes. Still at times they can prove very embarrassing.

The burden of these foreign obligations has been enhanced on account of a rise in the value of money or owing to a fall in prices. This has diminished the profit-earning capacity of the assets which correspond to these debts, and India has been finding it exceedingly difficult to meet the charges without imposing a very heavy strain upon her resources. In other countries, negotiations are going on between the debtor and the creditor nations for a reconsideration of the debt question. India's case for revision is still stronger, for countries like England acquire the necessary foreign balance by the export of manufactured goods, whereas India mainly depends upon the exports of raw produce, whose prices have fallen to a much greater extent than those of the manufactured goods.

EFFECTS UPON EXCHANGE

✓ The external obligations of India also exert a considerable influence upon exchange. The Government makes provision for them at some fixed rate of exchange and in order that their estimates may not be falsified, they have to do every thing possible to maintain that rate of exchange. Even if economic conditions alter the situation to such an extent that the rate cannot be maintained, the Government persist in maintaining it as far as they can. Thus these foreign obligations are exerting a great deal of influence indirectly upon our internal price-level through the rate of exchange. Probably a large part of our recent economic trouble can be traced

to this source. In order that in a period of depression a smaller revenue may meet the same obligations, the Government would be naturally inclined to raise the value of money in order to raise the rupee exchange. But a rise in the exchange value of the rupee checks exports and stimulates imports, which impedes our industrial development and reduces the balance of trade out of which these obligations must be met. Thus the very method applied by Government to lighten the burden of the payments upon the Indian Exchequer has the effect of reducing our trade balance.

PROBLEMS *re* EXTERNAL CAPITAL

Foreign capital raises important problems. The first question is whether foreign capital should be allowed to come freely into the country under the control and management of foreigners in the form of investment capital. If the answer be in the negative, what restrictions should be imposed thereon? It is now an economic truism that foreign capital in the form of loans to be used for productive purposes either by Government or for commercial and industrial investments by nationals is an imperative necessity to develop the economic resources of a backward country. In this case the borrowers judge whether the capital is available on reasonable terms and conditions. Such transactions are to be distinguished from the import of foreign capital under foreign enterprise. The uncontrolled influx of foreign capital into a country confers serious disadvantages upon the economic and political independence of a country. It becomes a question of time only as to when foreign investments should modify the foreign policy of a particular country. To give a concrete example, the Sino-Japanese troubles are due to the economic interests of Japan in China. Egypt has also been in such a situation and the political troubles there regarding the Sudan question and the rights over the Nile waters are to be attributed to the inspiration of commercial vested interests. The issues arising out of commercial and financial safeguards in the case of India may be traced to the same source. In fine, wherever foreign capital has been allowed freely into a country, international financial difficulties have come into existence.

FISCAL PROTECTION

Foreign obligations involve a disadvantage to India in the matter of tariff policy. India is now committed to a policy of protecting her infant industries. When restrictions are imposed upon the free entry of foreign goods, they are inevitable on the entry of foreign capital also; otherwise foreigners would export their capital and run their own enterprises in India. This would be a grave menace to Indian-owned enterprises as the foreign enterprises would get the advantage of

the Indian tariff wall and compete with Indian concerns. It might be said that foreign capital would give employment to Indians ; but this would not be ultimately to the advantage of India as it would turn Indians from consumers of foreign goods to employers of foreign capital. The object of the policy of protection is to develop India's resources with Indian capital and for the benefit of Indians. When protection involves sacrifice, it is necessary that as far as possible the benefits of these sacrifices should also be secured for Indians. If foreigners want to take advantage of the protected market of a country, it should be on terms fixed by the nationals, who have to bear the burden of protection. "It is one of the first postulates of national economy followed in practice by many of the advanced countries that in a protected market foreign capital cannot have absolute freedom, for that would destroy the significance of protection." In India, however, this principle does not seem to have principally determined the policy of the Government, presumably owing to the powerful opposition of vested interests.

REDEEMING THESE OBLIGATIONS

An important issue in relation to these obligations is whether they should be repaid or the payment of interest should continue. The debts of a productive nature may not require an urgent repayment ; but in response to canons of prudent public finance all unproductive debts must be ultimately extinguished. Every nation must have a definite plan even to reduce productive debts. This is necessary for two reasons. Firstly, the accumulation of current revenue surplus should be devoted either to reduce the existing obligations or to avoid the increase of these obligations in the future. The principles guiding the finances of commercial corporations should as far as possible apply to the problems of public finance. The accumulation of public debts means a burden on national finances and imposes a strain on the future generations of tax-payers. It also deprives other national services of their share of help from the national budget.

Another important consideration requiring the redemption of debt is the maintenance of the credit of a State. In modern times, constant borrowing on the part of Governments has become an imperative necessity. Provision for debt redemption is, therefore, absolutely essential to avoid a crushing debt burden and to facilitate borrowing at reasonable rates of interest in the future. We cannot go on borrowing larger sums of money year after year without impairing the national credit. The fact that modern states are constant borrowers makes it necessary that they must have a set plan of repayment. The period of repayment may be longer or shorter

according to the nature of the assets created by the debt; but a planned repayment is absolutely indispensable.

A perusal of the methods of debt redemption that existed in India some time back may be made in a cursory manner to pave the way to describe the improved provision recently made. Formerly, there were three methods for debt redemption. Firstly, a portion of the capital invested in State railways was repaid with railway annuities and sinking funds that were accumulated out of railway earnings. Secondly, a part of the annual Famine Insurance grant of one million sterling was also used for reducing debt. Thirdly, before the War, in prosperous budget years, at times surpluses were utilised in writing down the unproductive portion of the Indian public debt. These methods were not, however, systematically followed as they did not form a part of a deliberate policy of debt redemption. Further, in the post-War period, the recurrent budget deficits stopped even these attempts at debt redemption.

THE SCHEME OF SIR BASIL BLACKETT

It was Sir Basil Blackett who formulated a systematic policy of debt redemption in India. He laid down a comprehensive scheme in 1924 for co-ordinating and regularising the existing provisions for debt redemption into one general Sinking Fund to reduce the Indian public debt. He suggested 80 years as the period of redemption and the scheme was in the first instance applied to the quinquennial 1925-26 to 1929-30. It was estimated that a sum of nearly £2 million or 298 lakhs of rupees would be required for reducing or avoiding the debt in England. This arrangement eased conditions in the money market and the Government almost immediately got more favourable terms for conversion and re-borrowing. A large part of the War and post-War debts was converted into lower-rated loans, which implied considerable savings on interest charges. The rise in the exchange rate after 1922-23 also had the effect of reducing the amount of rupees that we had to pay on sterling obligations by way of interest.

DEFECTS OF THE SCHEME

The scheme has certain defects from the financial point of view. Firstly, no part of the Sinking Fund was kept in London to buy up our sterling securities in the event of a fall in their prices. The range of prices of India's sterling securities is lower in London than in India and, therefore, this omission is rather surprising. For this purpose, Australia and South Africa maintain a part of their sinking funds in London. Another defect is the lack of a cumulative character of the sinking fund. The scheme does not provide for the investment and re-investment at a compound rate of interest, and

thus it will not appreciably assist in reducing the total amount of our public debt ; because it can only be taken as a contribution towards capital expenditure from revenues. Both Australia and South Africa maintain cumulative sinking funds.

A comprehensive and carefully planned National Debt Redemption Fund should be devised to reduce India's external obligations. It is necessary to have two separate redemption funds for extinguishing our external and internal obligations. The basic principles of these two funds would be identical, but the annual amounts to be provided, their location and management would be governed by different considerations.

In certain years it may not be possible to make provision for both funds. In those cases, provision should be made for the Foreign Debt Redemption Fund ; and in fact, contributions to this Fund should be made obligatory, so that no Finance Minister may avoid setting aside a certain amount for the repayment of our foreign obligations. "Methods of easy finance should not be allowed to interfere with the repayment of our national obligations. It ought to be clear to all students of public debt that any considerable reduction could only be accomplished by the introduction of a fixed minimum budgetary provision for debt redemption."

This task may be entrusted to some kind of statutory body as in France and South Africa, which may be called "The National Debt Commission". It would be the duty of this body to use the fund for the purpose and for the cancellation of old securities or for investment in new loans. The Commission would fix up periods for the redemption of debts of different kinds and they would arrange for interest and sinking fund to come from the various borrowing bodies and provide for the yearly reduction of our unproductive debt out of the general revenues of the Central Government.

The existing Railway Depreciation and Reserve Funds can also be put to a better use to reduce our foreign obligations. The object of the Depreciation Fund is to provide for the replacement of wasting assets ; while the Reserve Fund aims at making provision for contributions to the general revenues and for writing off capital. These funds are invested on behalf of the railways, but their interest is credited to railway revenues. As a matter of principle, such investments should be permitted to accumulate at compound interest and their annual interest should not be credited to the railway revenue account.

POSSIBILITY OF CONVERSION

In case the immediate repayment of our external obligations or their redemption within a reasonably short time is found difficult, the possibility of their conversion into internal loans should be considered. With the proceeds of the rupee

loans, our sterling obligations can be met. The provision of Debt Redemption or Sinking Fund and the conversion scheme should go side by side. The advantages of conversion will be lower interest rates and the income to Government through taxation of interest on rupee loans.

The policy of conversion of sterling obligations of higher rates of interest into those of lower rates should be seriously considered ; because a large part of our sterling borrowings was made at very high rates of interest. A systematic programme should be laid down in this connection.

The annual obligations of the Government or the Home Charges have been expanding and considerations of sound finance necessitate their gradual reduction, because they do not bring in any commensurate return, but have got to be paid off in the same way as productive debts. Relief is also needed in regard to the civil and military charges ; and there is particular scope in this direction. This also calls for a systematically planned and well-conceived scheme.

In this connection Britain and India might come to terms with particular reference to pension charges. India may pay to Britain an agreed amount in settlement of pension charges after which the liability to meet them would devolve upon Britain or we can agree to pay her a fixed annuity for some years in consideration of her undertaking to assume liability for the charges on account of pensions and salaries. India should have the option of commuting the remaining annuities into a capital sum whenever she is in a position to do so. This would necessitate a progressively accelerated reduction in foreign recruitment for Indian services and its ultimate extinction.

COMMERCIAL INVESTMENTS

The foreign commercial investments have certain problems peculiar to themselves. They differ from Government debts inasmuch as the claim of the investor in the case of the public debt is on the nation as a whole, whereas in the other case it is on the individual borrowers or private companies which have contracted these loans. These loans may be either under foreign management or they may have been borrowed by Indians and invested in business. The amount of the latter class is very small as compared with that of the former, but it is likely to increase in the future. They are, however, similar to public debts, because the payments for them have to be found by India in the form of goods and services and the transfer of these values has effects upon the balance of payments, upon exchange and upon the growth of national wealth. They necessitate some scheme of regulation and control. It should be seen that the investment of foreign

funds by nationals is in productive enterprises and does not add to our dead-weight debt; while in the case of funds brought by the foreigners themselves and invested here, ways and means should be devised for their reduction and for their further stoppage.

It is clear that they cannot be completely prohibited. But certain basic industries like mining, coastal shipping, plantation, etc., can be reserved to the nationals of the country, thus involving a curtailment of the scope of foreign capital investments in certain directions.

On economic grounds foreign industrial enterprises should be excluded from the benefit of direct State bounties or subsidies; otherwise it would mean the handing over of Indian tax-payers' money to foreign investors. Foreign enterprises intending to set up business in India to take advantage of a protected market should be rigidly controlled. If foreign investors want to benefit from a policy of protection in India, it must be upon terms acceptable to Indians. Foreign investment in protected industries should be subject to certain restrictions, those for instance, which were laid down by the External Capital Committee. But unfortunately such restrictions do not find an adequate place in the Government of India Act of 1935.

There is one important aspect of our borrowing policy to which attention may be drawn at this stage. There is the identity of the agent of the borrower with that of the lender and this position is very anomalous indeed. This has been responsible for suspicion among Indians that the loans in England have not been obtained on terms favourable to Indians and that interest rates have been excessive and the proceeds of the loans have been utilised for purchasing British materials whose prices have not always been scrutinised as carefully as if Britain were buying for herself. At times loans have been raised not because the funds were needed but merely because of exigencies of exchange or the difficulty of making remittances.³

CONCLUSION

The external obligations as shown above exercise strong influences upon our economic conditions in various ways. They impose a heavy burden upon the finances of the country and consequently upon the tax-payer. They materially determine the balance and direction of our foreign trade and also influence the rate of exchange and the level of prices within the country. They have also been responsible for the creation of vested interests who stand in the way of India's economic freedom. These obligations must, therefore, be

³ N. R. Sarker, *The External Obligations of India*, pp. 24, 25.

redeemed as early as possible. Further borrowing must be curtailed considerably and stopped unless it be absolutely essential. Current charges thereon can be reduced by availing of easier money conditions to effect conversion and also by converting sterling loans into internal rupee loans whenever circumstances are favourable for this course. Foreign recruitment for the services should be stopped to reduce expenditure upon pensions and salaries and pensions should be commuted with Britain on the basis of fixed or variable annuities. In these various ways our foreign liabilities can be reduced progressively; but this requires a carefully-thought-out and deliberately-planned scheme of reduction of these liabilities, which will pave the way for their ultimate extinction.⁴

⁴ *Ante*, pp. 121, 122.

CHAPTER XV

Financial Administration

THE State has certain important functions to perform and the scope of these functions has increased considerably in the present century. In order to discharge its duties systematically and in the best interests of the country, the State must be provided with a systematised plan of work. Finance plays a very fundamental part in the framework of that plan; because the plan cannot be properly executed or the duties and functions of the State cannot be discharged in the best interests of the country without first knowing how much money will be required to carry them out and without finding out ways and means for meeting that expenditure.

Financial administration is thus an important branch of public finance, which has received considerable attention in recent times. The study may be considered in three parts: (1) the preparation of the Budget; (2) its legislation or voting; and (3) its execution.

The Budget is in reality the pivot of the administration as the absence of a sound Budget is bound to throw a State into financial insolvency. The word "budget" is derived from the French word "bougette," which meant a case in which the Chancellor of the Exchequer kept his papers. In 1763, the expression was first adopted in England when the annual statement of expenditure and income was called "opening the budget." In 1803, the expression was adopted in French financial terminology as a substitute for estimates of receipts and expenditure. Financial administration is a study of the principles governing the Budget and also a study of the underlying laws and conventions.

The Budget is an annual statement of expenditure and revenue prepared by public authorities which usually covers two fiscal periods—the closing period and the period to come. In short, it is a statement of the receipts and expenditure of the preceding year, an estimate of the receipts and expenditure of the coming financial year, and proposals regarding the ways and means for meeting a deficit or distributing a surplus.

To present a balanced Budget is a service of a far-reaching nature that can be rendered to the State by a Finance Member. This requires unusual qualities in him. He must bring to the task of public finance a keen and alert mind, a natural business capacity and a genuine and practical sympathy with the mercantile community.

THE PREPARATION OF THE BUDGET

The Budget is prepared by the Executive for the legislature. The methods of preparation of the budget differ in detail in different countries ; but the general principles are the same. In India, the budget is presented to the legislature generally four weeks before the close of the financial year ending on the 31st of March, so that the whole discussion may be completed before the ensuing year begins. Various departmental heads prepare their estimates which are in some cases taken in hand early in August of the previous year, namely, six or seven months before the end of the financial year. The returns filled in are in three parts. Firstly, the revenue and standing charges of a permanent nature as the salaries of the permanent establishment and ordinary contingent expenditure : secondly, charges of a fluctuating nature, but not being new objects of expenditure ; and finally, new items of expenditure. The estimates give the actual expenditure of the previous year, the expenditure sanctioned for the current year and the anticipated expenditure for the ensuing year. In this country the estimates do not include any new charge unless the same is sanctioned by a competent authority.

The heads of offices submit their estimates to the Administrative Departments of Government at headquarters and the latter scrutinise the estimates. The first part referred to in the above paragraph is mainly scrutinised by the Administrative Department and the Accountant-General ; while the second part is reviewed by the Finance Department and the Accountant-General, the latter accepting the orders of the Finance Department as final. The third part of the return is very carefully scrutinised. Before placing the expenditure in the budget, the head of the office obtains the administrative approval of the Department. These new items come under a careful scrutiny of the Finance Department also. The Administrative Departments then forward to the Finance Department memoranda explaining the necessity of each new item of expenditure, so that these explanations may come first before the Finance Committee of the legislature and then before the legislature itself in a statement of new items. This statement will show : (1) the cost of the new items and the head by which the same should be borne in the budget ; (2) whether the cost is recurring or non-recurring ; and (3) any explanatory memorandum giving the reasons for the new expenditure. The Accountant-General includes these approved items in the preliminary budget forecast submitted to Government in December. In India in each province there is a Finance Committee of the Legislative Council with the Finance Member as the Chairman. There is no provision for the Finance Committee in the constitution or in the Rules, while the Public

Accounts Committee which reviews the expenditure after it has been incurred has a position under the Rules under the Government of India Act.

Two editions of the Budget are prepared by the Accountant-General: one on the basis of the actual eight-monthly figures, and another on the basis of the nine-monthly figures. The second edition of the Budget is prepared by about the second week of February, and changes based on ten months' actuals are incorporated in the Budget. The Budget is then ready for being presented to the legislature. In November, that is, eight months after the beginning of the financial year, four sets of figures are available for Budget purposes: (1) the accounts or final figures of the previous year; (2) the budget estimates of the current year; (3) revised estimates for the current year; and (4) the budget estimates for the following year.

In India the budget is prepared before the monsoon falls, and consequently, there is considerable uncertainty in the finality of the figures. The selection of the financial year, and the fixing of the date of the presentation of the Budget to the legislature are determined by administrative convenience. Importance is also attached to the accuracy in forecasting the revenue of the coming year and in finally estimating the receipts and expenditure in the preceding year. It was for this reason that the Chamberlain Commission suggested in relation to India the consideration of the question of the calendar year or the commencement of the year from the 1st of November; but the suggestion was not accepted. Further, the sanction of the legislature should be secured in time for raising taxation and authorising expenditure, and these two considerations should mainly govern the selection of the dates.

THE CONTENTS OF THE BUDGET

Another important question is whether receipts and expenditure should be gross or net, and to what extent detailed heads of expenditure should be given. If gross figures are given, all transactions will ordinarily be placed before the legislature; but certain heads of income and expenditure will be unduly swelled, *e.g.*, those connected with commercial services. Where the expenditure in the revenue-yielding departments is low and receipts in the spending departments small, net figures are of great importance; but on a balance, gross figures are preferable, except in the case of commercial concerns where the budget proper may include the net figures; while the date relating to the gross revenue and expenditure may be in the form of an appendix. This would give more information and would be better for the country's finance in the long run; because the legislature would be in a better

position to appreciate and pass judgment on the state of affairs.

The budget should be comprehensive, accurate and intelligible. The revenue and expenditure heads should be properly classified so that the legislature may be able to discuss without difficulty all questions of public interest and policy and to record their vote without prejudicially affecting other items of revenue and expenditure. The classification of the heads should be permanent as far as possible and there should be no change without ample notice ; otherwise the real budgetary position would be impaired.

THE VOTING OF THE BUDGET

The next stage in financial administration is the passage of the Budget through the legislature. It is mainly through the Budget that the general policy of the Government is controlled. In India each Provincial Government has a separate budget. According to the Act of 1921, the Provincial subjects are divided into two classes : (1) Transferred, that is, those services which are placed under the charge of a Minister selected out of the elected members of the legislature, and (2) Reserved, that is, services which are not under popular control but are in charge of a Member of the Executive Council of the Governor. Except certain items, the whole expenditure on reserved and transferred subjects is voted on by the Legislative Council. The budget estimates for expenditure are placed before the Legislative Council in the form of demands for grants and the legislature has the final say with regard to the expenditure proposed for the transferred services. The Council may not increase the grant. In reserved subjects the Governor can overrule the legislature if the amount sanctioned is thought to be insufficient. The Governor is also empowered in regard to both classes of subjects in emergency cases to authorise such expenditure as may be necessary in his opinion for the safety or tranquillity of the province, or for the carrying on of any department. Barring certain items, the entire expenditure of the Central Government is voted on by the Legislative Assembly. The Governor-General in Council can overrule the Assembly if the expenditure refused by it is essential for the discharge of his responsibility. In emergency cases he can also authorise such expenditure as is necessary in his opinion for the safety or tranquillity of British India or any part thereof. The method of examining the budget is not uniform in all countries, but differs from country to country. In India and the self-governing Dominions the British example is followed to a great extent. In England, the Chancellor of the Exchequer in April in each year lays before the House of Commons (1) a statement of the actual results of the revenue

and expenditure in the past financial year showing the extent to which his estimates have been realised, and if there has been any surplus or deficit in the income as compared with expenditure and (2) a statement of the estimates of the revenue for the ensuing year, on the supposition that taxation would remain as in the past year, and also on the estimate of the expenditure in the current year. In the case of a surplus, a remission or reduction in taxation may take place; while in the case of a deficit proposals for new taxation are submitted.

There is a speech from the Throne, a speech containing a reference to the financial requirements of Government, and the first vote is that the supply be granted. When the formal vote of supply is passed, the House of Commons by another vote appoints a day on which it will resolve itself into a Committee of the whole House to consider the supplies to be granted. This is known as the Committee of Supply. This Committee examines the budget. Then the House resolves itself into a Committee of Ways and Means to consider the ways and means of raising the money required, and the Chancellor of the Exchequer delivers his budget speech in this Committee of Ways and Means. The budget must also be discussed in the House of Commons and the discussion in the Committee of Supply lasts for 20 days when the guillotine is applied. The remaining votes are then put to the House without discussion. Inside the House the Executive is represented by heads of the Departments, specially by the Members of the Cabinet. The Lower House has the final voice in regard to all financial business. The British Parliament exercises control "(1) by legal restrictions, which prevent the Crown or its Ministers from imposing any charge without the consent of Parliament either in the form of taxation or expenditure or loans, and, from maintaining a standing army in time of peace; (2) by the doctrine of the constitution, by which supplies are granted annually by the House of Commons, this supply necessitating statutory sanction each year; (3) by the rule of the constitution by which Ministers of the Crown are held responsible to Parliament for any act done by them in their ministerial capacity or for any advice tendered by them to the sovereign; (4) by means of the rule by which supply granted must be appropriated to the particular purpose for which it was granted; (5) by the presence of Ministers in Parliament, so that their actions can be examined and criticised; and (6) by other means, e.g., Parliament may be supplied with information, such as by questions and answers, by royal commissions or committees, and by "command papers", which with the exception of the annual estimates which are printed by the order of the House of Commons, are printed on the authority of the Department

presenting them.”¹ In each House, Command Papers are presented by being laid on the table by the Minister responsible for them, and by being delivered to the clerk of the Parliament during a recess they may be presented to the House of Lords or to the House of Commons by delivery to the librarian of that House. By means of an address to the Crown or by the order of the House, either House can obtain information from any department regarding its work or administration. It is not generally possible for any member of the House, except a member of Government, to propose expenditure; but he can move a resolution to the effect that public money might be spent in a particular manner, and the resolution is binding if the House accepts it. A private member cannot, however, move that a certain sum be granted for a particular purpose; because it must emanate from a Minister of the Crown.

In India, the Budget is presented in the central legislature to both the Houses at the same time, to the Upper House by the Financial Secretary and to the Lower House by the Finance Member. In his Budget speech the Finance Member deals with the general economic conditions in the country, and explains the variations between the budgeted revenue and expenditure, and ways and means for the coming year are also dealt with. In the provinces, the Budget is presented to the Legislative Council by the Finance Member.

The discussion on the Budget does not take place on the date of its presentation. The discussion is in two parts: (1) a general discussion and (2) the voting of supplies. The general discussion takes place about a week after its presentation and a day or two are allotted for same. At this stage, details cannot be discussed. Certain subjects are non-votable according to the Government of India Act; but the Governor-General has the power to allow them to be discussed to meet the wishes of the legislature. Then comes the voting of supplies for which 15 days are allotted, and no single demand can be discussed for more than two days. If the discussion is not finished within 15 days, the President disposes of all the outstanding grants by simply putting them to the vote without any discussion. From 1923 the practice has been adopted according to which the Government consults the convenience of the members with regard to the order in which the demands may be discussed. Each demand is introduced by the member in charge of the department, and they are voted by major heads of expenditure. They may be reduced by the Assembly with a view to effect economy and retrenchment. Motions for reduction are usually brought forward to elicit information.

¹ Findlay Shirras, *The Science of Public Finance*, pp. 573, 574.

The Finance Bill is introduced in the Assembly after formal permission for its introduction has been granted. The discussion is opened by the Finance Member, and after this is finished the Bill is taken up clause by clause with the schedules. After its passage in the Legislative Assembly, the Finance Bill goes to the Council of State, which does not discuss the demands for grants in detail. It discusses in detail only the Finance Bill which deals with revenue. After it is agreed to by the Council of State, the Bill has to receive the assent of the Governor-General, when it becomes law. If it is not assented to or is amended, as was the case with the Finance Bill of March 1935, it is returned to the Assembly for further discussion. The Act provides for a joint sitting of both Houses ; but as it takes place only after six months, the Bill cannot wait till then. The only course then is either that the Assembly should accept the amendments of the Council of State or the Bill can be passed under certification before the month prescribed under the Provisional Collection of Taxes Act expires.

INITIATION OF MONEY BILLS BY GOVERNMENT

As a general rule, in most countries money Bills can be initiated only by Government. The legislature can reduce or refuse supplies or taxation, but it cannot originate or increase them. In India also, expenditure or taxation both at the Centre and in the Provinces can take place on the recommendation of the Executive Governments and not on those of the legislature. According to the English constitutional rule demands for supply can only proceed from the Crown. The legislature can reduce, but it cannot increase expenditure. In India also, an amendment, except by a member speaking on behalf of the Government, which has the effect of increasing taxation proposed by the Bill is not in order, unless it proposes taxation by way of equivalent to a tax brought by the Bill under consideration of the legislature. The point at issue is that the demand comes from Government, which can propose taxation. The Council cannot increase the demand or taxation except at the instance of a member of the Government ; but it can reduce same. It is, however, open to members to propose an increase in one item compensated by a corresponding reduction in another item. In this connection, the following ruling of the President of the Indian Legislative Assembly may be cited on the point. He said, "I think it is obvious that the Imperial Parliament intended to confer the same powers and the same restrictions regarding the levy and appropriation of public revenues which it itself enjoys. Neither the House of Commons nor the Legislative Assembly is empowered to increase a demand for a grant. The House of Commons is equally forbidden to increase a tax. The general

principle has been laid down many times, and I think that it is one which we ought to apply here. Therefore, those amendments which propose increases of taxation will not be in order.”²

REAPPROPRIATIONS AND RESERVE FUNDS

The question of reappropriation deserves consideration ; because it necessitates the sanction of the legislature in most cases. The power to reappropriation in modern constitutions is generally conferred on Governments under rules or otherwise. In India after grants have been voted by the Legislative Council, the Finance Department can sanction reappropriation within a grant from one major, minor or subordinate head to another. Every reappropriation from one grant to another, and every reappropriation within a grant not conforming to the rules of the Finance Department, should be brought to the notice of the legislature. In some countries token grants, *i.e.*, demands for nominal sums, the total expense being by reappropriation, are applied for simply to bring the matter to the notice of the legislature. The Executive is also generally left with certain funds to be used as a reserve and to be accounted for in the next budget.

VETO AND CERTIFICATION

The power of veto and certification is generally provided for in modern constitutions. The Indian constitution provides that when legislation is refused to be passed by the legislature, it may be certified by the Governor-General or the Governor of a Province. In regard to local legislatures according to the Act of 1921 the Governor can certify only in the case of reserved subjects. The Governor-General has also the power to restore grants refused by the legislature. These powers have been maintained in the new Act also.

THE EXECUTION OF THE BUDGET

After the Budget has been voted on by the legislature, adequate machinery is necessary to give effect to its wishes. This branch of the subject is known as the execution of the Budget. It includes the collection of revenue, the services performed by the Treasury or the Finance Department and the mode of spending in accordance with appropriations. The topics of control and audit also belong to the scope of this aspect of the subject.

In India, the revenue collection is supervised by District Magistrates ; while there is separate departmental staff for collecting customs, income-tax and excise revenue. Then for

² *Legislative Assembly Debates*, p. 3719, 19th March, 1923.

the movement of funds from one place to another, there is Paper Currency Reserve distributed throughout the country in the various treasuries by means of currency chests through which funds are transferred. The Imperial Bank of India conducts the treasury business wherever it has a local head office. The deposit of notes in a currency chest decreases the amount of notes in circulation, and the deposit of rupees in a currency chest increases the amount of coin in the Paper Currency Reserve. When notes or coins are deposited in a currency chest, the Government is enabled to issue notes elsewhere up to the amount of the deposit.

With regard to the method of spending it may be said that in India the work of communicating grants to the disbursing and controlling officers is taken up immediately after the passage of the budget. Grants are divided into primary units of appropriations and they are sometimes further subdivided for purposes of financial control. Appropriation is in force only up to the close of the financial year, and this requires considerable control to avoid extravagance and a rush of expenditure in March. The unspent portion of the grant lapses in March and, therefore, the Government departments concerned make a rush to spend that money. Before incurring any expenditure, both administrative sanction and budget provision are necessary. Only one of the two by itself is inadequate. Engineering works, for instance, require in addition to administrative sanction and Budget provision what is known as the approval of the plans and estimates. The actual expenditure is watched by the heads of departments concerned. The Accountant-General in each province communicates with the Finance Department if the expenditure is likely to exceed the budgeted amount. A review of the estimates for the current year takes place four times annually, once after three months, the second after six months, the third and fourth being the Budget forecasts referred to above.

SYSTEM OF FINANCIAL CONTROL

Ever since the time of the East India Company the British Parliament has been exercising control over the Indian finances through the Board of Control in the beginning, and later, through the Secretary of State in Council. Up to the introduction of the Reforms this control remained absolute, but administrative convenience and promptitude of business had necessitated a delegation to the Indian authorities. The Governor-General in Council could incur a limited amount of expenditure without the previous sanction of the Secretary of State, and the Government of India exercised a rigid control over provincial expenditure. Taxation proposals required the previous sanction of the Secretary of State and the Government of India

could not raise loans in India without his consent. The introduction of reforms in 1921 involving a partial control of the Executive by the provincial legislatures has rendered inevitable a considerable abatement of the control hitherto exercised by Parliament and by the Secretary of State.

The manner in which the central and provincial legislatures exercise their influence over finance together with the powers of the Secretary of State and the way in which his control over Indian financial administration is made effective are described below.

LEGISLATIVE CONTROL

The legislative control over Indian finance under the Government of India Act of 1919 is modelled on the British system. Corresponding to the Estimates Committees in England, there are Standing Finance Committees attached to the central and provincial legislatures, whose business is to scrutinise the proposals for fresh expenditure and suggest economies. The Finance Member, like the British Chancellor of the Exchequer, opens his budget with a detailed survey of the financial position and certain taxes are voted annually in the central legislature. Certain demands of the Government are to be voted by the legislatures annually, but items like debt charges, army expenditure, salaries of certain officials and services are not subject to vote. There is an elected Committee on public accounts to consider the Report of the Auditor-General through the instrumentality of which the legislatures satisfy themselves that the money voted by them is satisfactorily spent.

The Standing Finance Committees were intended to be advisory bodies and were not to have any administrative control of departments. Their object was to familiarise the elected members of the legislatures with the process of administration and to make the relations between the Executive and the legislature more intimate. They are presided over by the Finance Member and contain a majority of members elected by the legislature. The nature of their work and the range of their influence over administration have varied considerably in the different provinces. Their functions are to examine proposals for new taxation, to advise on supplementary estimates and to consider and initiate proposals for retrenchment. In the provinces, "there has been a distinct tendency to encroach on the sphere of administrative policy", but the Standing Finance Committee of the Legislative Assembly has been a purely advisory body and has confined its activities to an examination of new proposals for expenditure. The Committee "has usually taken a reasonable and intelligent view of its duties" and has helped to familiarise the elected members and the public with the details of financial administration.

ESTIMATES AND SUPPLY

On being approved by the Governor-General in Council, the estimates of revenue and expenditure of the Central Government are laid before the Assembly on the occasion when the Finance Member makes his budget speech, which may not include proposals for new taxation. The statement of the Finance Member is followed by a general discussion regarding the whole field of administration, but no motion is moved at this stage and the discussion is not detailed. The debate furnishes the legislature with the opportunity of criticising the revenue estimates and the loan policy of the Government.

The second stage consists of the presentation of the Government demands to the Assembly in the form of a series of motions. A limited time is allotted for the discussion and the items of debate are chosen in consultation with the opposition leaders, the rest of the votes being put without debates. The non-votable heads also can be thrown open to the discussion of the House at the discretion of the Governor-General and this practice has been invariably followed. The non-votable expenditure can also be attacked by moving a cut in the votable expenditure ancillary to it. For example, the non-votable defence expenditure can be criticised by moving a reduction in the expenditure proposed to be voted for the secretarial establishment of the Army Department.

Even in the case of the votable items the refusal of the Assembly to vote an item is not necessarily effective, because the Governor-General in Council has the power of restoring a cut made by the Assembly. This power has been used on many occasions. There is also a reserve power by which the Governor-General can authorise such expenditure which he deems necessary for the safety of British India.

Provincial procedure is also on the same lines. The Government's proposals are laid before the Legislative Council when the budget is presented by the Finance Member. The budget statement is followed by a general discussion and then the demands for supplies are dealt with. The proportion of voted to non-voted expenditure is greater in the provinces than at the centre.

THE FINANCE BILL

There is an annual Finance Bill at Delhi, introduced at the time of the budget speech of the Finance Member, though it is discussed after the estimates have been passed or certified. All the central taxes except the tariff are annually voted. In the provinces there is no annual Finance Bill. The Indian practice of the annual Finance Bill dates from 1921 when an

amendment to the Taxation Bill was moved to limit its operation to one year, whose object was to establish a convention similar to that in force in the House of Commons.

PUBLIC ACCOUNTS COMMITTEE

There is a Public Accounts Committee of the Central Legislature, consisting of eight members elected on the principle of proportional representation, while three are nominated by the Government. The Finance Member is the Chairman. The position is embarrassing, because the Committee deals with financial irregularities of all the departments, including those for which the Finance Member is directly responsible.

The main functions of the Committee are to scrutinise the annual report of the Auditor-General, and to satisfy itself that the money voted by the legislature is properly spent. The Committee has exercised powers in respect both of the votable and non-votable expenses. It deals with the Auditor-General's report regarding extravagance in military expenditure, but in this case the report is in the first instance examined by a small *ad hoc* committee of officials. The Public Accounts Committee has no executive powers. It can make recommendations and point out irregularities, but it cannot issue orders or disallow any expenditure.

Its report is presented to the Assembly, but there has been no general desire to discuss it, because it is of too technical a nature to be of general interest. The deliberations of the Committee receive publicity and its scrutiny of expenditure "is jealous, detailed and enthusiastic". The constitution, powers and functions of the provincial public accounts committees are similar to those of the Central Committee.

SECRETARY OF STATE'S CONTROL OVER FINANCE

I. In the Provinces

The Secretary of State exercises control over the provincial transferred and reserved subjects. No proposal for the appropriation of funds can be made in respect of the transferred subjects except on the recommendation of the Governor. The previous sanction of the Secretary of State in Council is required under the Devolution Rules for certain proposals regarding expenditure in respect of transferred subjects before they can be included in a grant.

The control over the reserved subjects has been considerably relaxed, but the delegation of powers is by means of executive orders embodied in the Provincial Audit Resolution. The items of expenditure which require his sanction are the pay and allowances of all-India services, the expenditure of Governors, the expense on establishments exceeding a certain

amount and capital expenditure on irrigation and other public works exceeding Rs. 50 lakhs.

PROVINCIAL BORROWING

The provinces are within limits autonomous and the provincial budgets are not approved either by the Central Government or by the Secretary of State before presentation to the provincial legislatures. Provincial solvency is ensured indirectly by the control over provincial borrowings. Before 1920 the provinces could not raise loans in the open market and they could borrow only through or from the Government of India. Since the Reforms they have obtained considerable freedom in this respect, but their borrowings are regulated by statutory rules. No provincial government can raise a loan outside India without the sanction of the Secretary of State or within India without the Government's approval. They can borrow only for capital expenditure on projects of a lasting public utility, famine relief and repayment of previous loans. The bulk of provincial borrowings has been from the Central Government for which purposes a Provincial Loans Fund was established in 1925. In this manner the control of the Secretary of State and the Government over provincial financial solvency is ensured.

The Central Government is armed with other powers also. It can, with the previous permission of the Secretary of State, prescribe the procedure to be followed in the payment of money into and the withdrawal, transfer and disbursement of money from public account. It can regulate provincial programmes of expenditure so that provincial balances may not be reduced below a stated figure.

II. At the Centre

The Secretary of State maintains a rigid control over the financial administration at the Centre. The previous sanction of the Secretary of State in Council is required in a limited number of cases and the budget proposals affecting taxation require his previous sanction. He also controls the management of the gold standard and the paper currency reserves, the exchange and currency policy and the borrowings in India and England. In the matter of the Fiscal Convention, he is not expected to interfere when the Government of India and the legislature are in agreement.

THE AUDITOR-GENERAL

This control is exercised through the Auditor-General and his staff, one of whose principal functions is to see that the line of demarcation between the powers of the Secretary of State and the Indian authorities is maintained. This officer is appointed by the Secretary of State in Council and holds office

during His Majesty's pleasure. He is the final audit authority in India and an important part of the machinery through which the legislatures enforce economy in the administration of public finance. The Auditor-General has thus a dual responsibility to the Secretary of State and to the Indian legislatures and the compilation and audit of accounts are entrusted to this agency.

PROVISIONS OF THE NEW CONSTITUTION

I. In the Provinces

The financial proposals are based upon the principle that no proposal for the imposition of taxation or for the appropriation of public revenues can be made without the recommendation of the Governor; that is to say, that it can only be made on the responsibility of the Executive. Legislative procedure in financial matters differs in India from that in the United Kingdom. There is no annual Appropriation Act in India. The proposals for the appropriation of revenue which require a vote of the legislature are submitted to the legislature in the form only of Demands for Grants and a resolution of the legislature approving a demand is sufficient for the appropriation.

The proposals in the Constitution Act for the annual appropriation of revenue have been framed on the existing lines. They may be grouped in three categories: (1) those which will not be submitted to the vote of the legislature, though, with one exception, they will be open to discussion; (2) those which will be so submitted; and (3) others which the Governor may regard as necessary for the fulfilment of his special responsibilities.

The non-votable heads of expenditure falling in the first category are given below:—

“(I) Interest, Sinking Fund charges and other expenditure relating to the raising, service, and management of loans; expenditure fixed by or under the Constitution Act; expenditure required to satisfy a decree of any Court or an arbitral award;

(II) The salary and allowances of the Governor (these will not be open to discussion); of Ministers; and of the Governor's personal or secretarial staff;

(III) The salaries and pensions, including pensions payable to their dependants, of Judges of the High Court or Chief Court or Judicial Commissioners; and expenditure certified by the Governor, after consultation with his Ministers, as required for the expenses of those Courts;

(IV) Expenditure debitable to Provincial revenues required for the discharge of the duties imposed by the Constitution Act on the Secretary of State ;

(V) The salaries and pensions payable to, or to the dependants of, certain members of the Public Services and certain other sums payable to such persons."

The Joint Parliamentary Committee recommended that expenditure for the administration of excluded areas, whether derived from central or provincial revenues, should also be a non-votable item.

All other proposals for appropriation other than those falling in the first category and enumerated above would be submitted to the legislature in the form of Demands for Grants and it would be open to the legislature to assent to, or reduce, or to refuse assent to, any demand including demands necessary for the fulfilment of the special responsibilities of the Governor. In the latter case the Governor would be empowered to restore such grants ; while in the former case the decision of the legislature would be final ; and in this power would lie the real control of the Legislature over the Executive. It may be said that the heads of Non-votable Expenditure are so extensive that they would diminish the field of responsible government in the provinces.

POWERS OF LEGISLATIVE COUNCILS AND CONFLICTS BETWEEN THE TWO CHAMBERS

In the provinces where the legislature is bicameral, money bills shall be initiated in, and Demands for Grants submitted to, the Legislative Assembly alone. In the case of the possibility of a conflict between the two Chambers, the proposal under the White Paper authorised the Governor to summon the two Chambers after a lapse of three months to reach a decision on any legislation passed by one Chamber but rejected by the other. The Bill would be regarded as passed by both Chambers if approved by a majority of the members voting at the Joint Session. The Joint Parliamentary Committee regarded the period of three months as too short and suggested a duration of at least twelve months. In the case of Bills involving the special responsibilities of the Governor, the Governor is empowered to summon forthwith a Joint Session. In view of the relative powers of the two Chambers, a Bill introduced in the Legislative Council but rejected by the Legislative Assembly (the Lower Chamber) would lapse ; but the machinery of the Joint Session would be confined to the converse case and would be put in motion only if desired by the Legislative Assembly. The Bill would not be amended in the Joint Session except on points relating to the difference of opinion

between the two Chambers and the decision of the presiding officer on the admissibility of any amendment would be final.

II. *At the Centre*

It is unnecessary to repeat what has been said in connection with the Provincial Legislatures : but certain heads of expenditure which have no counterpart in the provinces and which would not be submitted to the vote of the legislature are (1) expenditure for a Reserved Department ; (2) expenditure for the discharge of the functions of the Crown in and arising out of its relations with the Rulers of Indian States ; and (3) expenditure for the discharge of the duties imposed by the Constitution Act on the Secretary of State. The inclusion of the first follows from the reservation of administration and control to the Governor-General. The second includes the expenses of the Political Department and other matters connected with the rights and obligations of the Paramount Power ; while the third refers to such matters as expenditure in connection with the Secretary of State's establishment in London, liabilities on contracts to which he is a party under the Constitution Act, and payments of compensation to members of the Public Services under his powers on that behalf.

RELATIONS BETWEEN THE TWO HOUSES

The two Houses of the Federal Legislature will have nearly co-equal powers ; but there will be a difference in the sphere of finance. Money Bills would be introduced only in the Lower House, the Upper House having power to amend or reject them ; and in relation to Demands for Grants the power of the Upper House would be limited to requiring at the instance of the Government that any demand reduced or rejected by the Lower House should be brought before a Joint Session. The Joint Parliamentary Committee recommended larger powers for the Upper House in relation to finance. It should be able not only to secure that a rejected Grant is reconsidered at a Joint Session of the two Houses, but also to refuse its assent to any Bill, Clause or Grant accepted by the Lower House. According to the Joint Committee "all demands should be considered first by the Lower House and subsequently by the Upper, and that the powers of each House in relation to any demand should be identical, any difference of opinion being resolved at a Joint Session to be held forthwith." (Page 117.)

There would be joint sittings of both Houses at the instance of the Governor-General under the following cases :—

(1) If a Bill has been passed by one Chamber, but rejected by the other ;

(2) There is no agreement on amendments to the Bill among the two Chambers;

(3) More than six months pass from the date of the reception of the Bill by the other Chamber without presenting it to the Governor-General for his assent;

(4) In case of Finance Bills and Bills relating to a matter affecting the discharge of his functions in his discretion, he can call a joint sitting even in the absence of disagreement between the Chambers and even if the said period of six months is not over, in case he is satisfied that the Bill will not be presented to him for his assent without undue delay.

In the case of differences at the Joint Sessions, the decision of a majority of the two Houses would be necessary; but in order to give an effective voice in the final decisions to the Upper House, a proportion of approximately 2 : 3 was endorsed by the Joint Parliamentary Committee. The period after which a Joint Session would be held is six months and it would not be held during the session of the legislature in the House of which the difference of opinion arose between the two Houses. In the former case, the Government would inform the legislature of their decision before the end of the current session. The above would be the ordinary procedure; "but in the case of Bills affecting the Reserved Departments, or Bills which in the opinion of the Governor-General involve his special responsibilities, or would affect the financing of the Federal Government's requirements, the Governor-General must have power in his discretion to summon a Joint Session and obtain a decision forthwith." Amendments to any Bill before a Joint Session would be governed by rules applicable to the Joint Session of the Provincial Legislatures.

COUNCIL OF INDIA

According to the Act of 1858 any expenditure incurred by the Secretary of State out of Indian revenues required the concurrence of the Council of India to grants or appropriations of any part of those revenues and the consent of both Houses of Parliament to the defraying from Indian revenues of the cost of any military operation beyond the external frontiers of India was necessary. Under the new Constitution the Council of India with a statutory control over the decisions of the Secretary of State in financial matters would not exist; and the authority of the Secretary of State would not extend to estimates submitted to an Indian legislature on the advice of Indian Ministers. There would, however, be a small body of advisers to advise the Secretary of State on financial and service matters and on matters concerning the Political Department. The Secretary of State is empowered under the new Constitution to appoint not less than three nor more than six persons

to advise him, of whom at least two must have held office for at least ten years under the Crown in India. He would be free to seek their advice individually or collectively on any matters, but would not be bound to do so except in one respect only. So long as he is charged with the control of any members of the Public Services in India, "he must lay before his Advisers, and obtain the concurrence of a majority of them to, the draft of any rules which he proposes to make under the Constitution Act for the purpose of regulating conditions of service, and any order which he proposes to make upon an appeal to him from any member of the Service, which he controls." (Page 227 of the *J. P. C. Report*). The Service of the Advisers should not have terminated more than two years before their appointment; and at least half of them should have the service qualification; while the Secretary of State would effectively participate in their deliberations in matters where the concurrence of the majority of his Advisers will be required.

CHAPTER XVI

Indian Budgets

A STUDY of the Indian Budgets of the last few years may now be made with a view to understand the practice of Indian finance and to see how that important branch of public finance which is known as "Financial Administration" is developed in this country. This study should also indicate the lines along which and the extent to which the Indian legislature exercises control over the Executive in this country in the sphere of finance and it should draw attention to the necessity of a greater measure of control of the legislature over the Executive in financial and fiscal matters in relation to India. The study of the budgets in the following pages is intended to be explanatory, descriptive as well as critical, and an attempt is made to approach this subject also with impartiality and moderation.

INDIAN BUDGET, 1933-34

The budget for 1933-34 was presented by Sir George Schuster, the Finance Member of the Government of India, on February 28, 1933. He proposed neither fresh taxation nor any relaxation in taxation. In his budget speech he said, "The story which I have to tell this year of the public finances of India is a simple and—viewed merely as a matter of public finance—a satisfactory one. The emergency plan, which we introduced in September 1931, was designed to produce budgetary equilibrium for the two years 1931-32 and 1932-33, and now as we approach the end of the second of these two years and take stock of the position we can confidently say that our plan has worked." The year 1931-32 closed with two crores better than expected at the time of the budget in the previous year with a deficit of $11\frac{3}{4}$ crores after providing for Rs. 689 lakhs for reduction of debt. The year 1932-33 closed with a surplus of 217 lakhs against the estimate of 215 lakhs after providing for 684 lakhs for debt reduction. Thus during a period of two years 1931-33 which may fairly be described as the two most difficult years for public finance which the world in times of peace has ever known, we shall not only have paid our way, but provided a balance of Rs. 415 lakhs for reduction of debt. This amply justified the great improvement in the credit of India. The Finance Member said, "It is interesting to make a short comparison between these results and the forecasts which I gave when I introduced the emergency plan in September 1931. We then

anticipated, after allowing for the normal provision for reduction of debt, a deficit of 10·17 crores for 1931-32 to be followed by a surplus of 5·23 crores for 1932-33 and that the net amount available for the reduction of debt in the two years, after allowing for the deficit on the combined results, would be 9·11 crores.....We now anticipate that the net figure available for the reduction of debt will be 4·15 crores so that we are about 5 crores below our original estimate for the two years. As the combined amount involved in the two years is about 260 crores on each side of revenue and expenditure, I think we may claim that our forecast showing a variation of only two per cent. from the result....was fairly near the mark."

Basing the estimates for the subsequent year on the assumption that the conditions would be similar to those of the current year, he had budgeted for a surplus of Rs. 42 lakhs. This reduction of the surplus took into account the following changes:—a fall of about one crore of rupees in the customs allowing for reductoin in imports of sugar and cotton piece-goods, and Rs. 1½ crores under salt owing to the disappearance of a special non-recurring addition during current year resulting from the abolition of the salt credit system. These reductions on the revenue side were counterbalanced by a reduction of Rs. 54 lakhs in the army expenditure and Rs. 36 lakhs in the civil expenditure in spite of the extra cost of Rs. 51½ lakhs and Rs. 28 lakhs respectively under these heads owing to restoration of 50 per cent. cut in pay.

The detailed position of the main items of revenue for 1932-33 and 1933-34 may be summarised as follows according to the budget statement:—

				Revenue in lakhs of
				Rs.
Customs—				
Budget Estimates	1932-33	..	..	52,31.27
Revised Estimates	1932-33	..	..	52,28.55
Budget Estimates	1933-34	..	..	51,24.60
Income-Tax—				
Budget Estimates	1932-33	..	..	18,73.38
Revised Estimates	1932-33	..	..	17,70.00
Budget Estimates	1933-34	..	..	18,23.00
Salt—				
Budget Estimates	1932-33	..	..	8,27.71
Revised Estimates	1932-33	..	..	9,23.23
Budget Estimates	1933-34	..	..	7,58.04
Opium—				
Budget Estimates	1932-33	..	..	61.01
Revised Estimates	1932-33	..	..	8.56
Budget Estimates	1933-34	..	..	62.69

Referring to the 'Finance Heads,' the Finance Member said, "It will be seen from what I have said that as regards Finance Heads there is no great change compared with the revised estimates for the current year. Net interest charges are down by 51 lakhs, Reduction and Avoidance of Debt is up by 4 lakhs and the net revenue from Currency and Mint is down by 61 lakhs. Interest receipts show a small decrease of 1 lakh. There is, therefore, a net deterioration of 15 lakhs."

The figures for two main items on the expenditure side are :—

				Lakhs of Rs.
Civil Expenditure—				
Budget Estimates	1932-33	..	..	20.65
Revised Estimates	1932-33	..	..	20.89
Budget Estimates	1933-34	..	..	20.53

In this connection the Finance Member said that there was a net reduction of 36 lakhs on the current year in spite of the following facts; first, that we have allowed for reducing the cut in pay to 5 per cent., thereby incurring extra charges of 28 lakhs on these particular Civil Heads; secondly, that we have to meet the normal increments in time-scale pay which still involve an annual addition of something like 15 lakhs; and thirdly, that we have to meet new obligatory expenditure amounting to about 17 lakhs. If all these items are taken into account it will be seen that the total of the net reductions otherwise effected under the normal heads of expenditure amounts to no less than 96 lakhs.' It must be said that the public is not concerned with items responsible for a decrease in savings, but only with the saving of 36 lakhs actually effected.

	Lakhs of Rs.
Military Expenditure—	
Budget Estimates 1932-33 allowing for 10 per cent. cut	.. 46.74
Budget Estimates 1933-34 allowing for 5 per cent. cut	.. 46.20

The comparison between the two years for the total budget is shown as follows :—

		Crores of Rupees		
		1933-34	1932	1933
		Budget	Budget	Revised
Revenue	..	.. 124.52	129.96	127.13
Expenditure	..	.. 124.10	127.81	124.96
Balance	..	.. .42	2.15	2.17

The net deterioration for next year is estimated at 175 lakhs as follows :—

	Lakhs of Rs.	
	Better	Worse
Revenue—		
Customs :—(Reduction due to fall allowed for in imports of sugar and cotton piece-goods) ..	..	1,04
Income-Tax :—(Increase due to removal of exemption from surcharge on Government servants)	53	..
Salt :—(Reduction mainly due to termination of temporary receipts or termination of credit system) .. .. .	..	1,63
Opium	25	..
Finance Heads :—(Net charges including additional expenditure of 1 on account of past restoration of cut in pay) .. .. .	..	15
Commercial Departments—		
Net Revenue .. .. .	..	11
Miscellaneous :—(Reduction of 30 due to no provision being included in next year's estimates for gain by exchange) .. .. .	..	45
Expenditure—		
Military-Civil Heads :—(Net reduction effected in spite of past restoration of pay cut costing 79½ lakhs under these heads as compared with the revised estimates. This net reduction together with the reduction of 5 under Irrigation and Currency and Mint taken on the revenue side gives a total reduction of 90) ..	85	..
TOTAL ..	1,63	3,38

The surplus after deducting 175 from 217 is thus reduced to 42 lakhs.

THE CUT IN PAY

The Government restored the cut to the extent of 50 per cent. whose total cost on the civil and army side for 11 months was estimated by Government to amount to 108 lakhs and taking into view the fact that the exemption of surcharges was withdrawn and more tax was expected to be yielded on incomes of Government servants below Rs. 2,000, the net cost of the proposal to the Government was estimated at 55 lakhs.

It should be said in this connection that the question from the point of view of the public is not about the net cost but about the total aggregate cost for full one year of the restoration of the cut; because in the absence of restoration the burden of taxation could have been reduced. The action of the Government in reducing the cut was highly indefensible. Ten per cent. was taken off the salaries when the surplus estimated was Rs. 2 crores, but when the estimated surplus was only Rs. 42 lakhs the Government had reduced the cut by 50 per cent. The Finance Member said, "The second

point is this that we regarded a cut in the fixed pay of Government officials as an extreme measure only to be taken in the very last resort after the efforts of all other feasible measures for dealing with the situation had been exhausted. Obviously a measure which is thus only justified in the last resort ought to be the first to go when any relaxation is possible.... To those who think that we have gone too far or that we ought not to have taken this step in priority to relaxation of measures of taxation, I wish particularly to emphasise that this must not be regarded as optional expenditure to be weighed in the balance against other possible demands on the public funds. Government is not really meeting its full obligations as long as it is not paying its fixed rates of pay of its officials—rates, moreover, which in certain cases are guaranteed by the Government of India Act.” The salary bill in India is very high. India has been made to pay much more than she can afford to pay. The service men in India get more than their compatriots in any other country of the world. The salary of the Finance Member of the Government of India is higher than that of the Chancellor of the Exchequer of His Majesty’s Government and the Governor-General of India is decidedly better off in this respect than any Minister of the Crown. Therefore, the special plea put forward by the Finance Member on behalf of the service men was not convincing.

The Finance Member talked of ‘sound finance’. He said, ‘Therefore, by sound finance I mean a policy which provides for the paying of the expenditure of each year by the income of each year and does not put on to the tax-payer of to-morrow a burden which is properly that of the tax-payer of to-day.’ It is true that expenditure of each year should be met from the income of each year, but what if the collection of the income causes an unbearable burden to the tax-payer of to-day? Should there be no consideration of the burden of the tax-payer of to-day in ‘sound finance’? Can he be squeezed to any limits for any period of time? If the income of a business man cannot go up or cannot even be maintained, he is bound to cut down his expenditure and even the salary of the manager will be reduced though the latter may have been engaged on definite terms. This is real, sound finance. The same principles should be applied to the case of Governments. Their expenditure should be reduced under certain circumstances and they cannot always start with the idea of a fixed expenditure to be met by increasing taxation. If this is not done, the finance cannot be called sound. The very fact that the cut in the pay can be restored, even partially, only when all emergency taxation is kept intact proves that these salaries cannot be paid by ordinary taxation. The scales of pay are guaranteed by the Government of India

Act, but is there any sort of guarantee, moral or legal, that the poor man in India will be allowed to eke out a livelihood? If without paying their scales of salaries at the full rate, the Government is not really meeting its full obligation, then is the Government really meeting its full obligation when more than 50 million people are unemployed and the burden of taxation is paralysing trade and industry? The Finance Member did not hold out any prospect of a reduction in emergency taxation, but assured the service men that 'what we hope is that conditions will so improve during the next year that it may be possible not merely to avoid retracing the step now taken, but to take the further step of restoring the full pay and *after that* making a start in reducing the burden of taxation.' In future if finances improve the benefit should first go to the tax-payer, but it will not be so unless full cut is restored. Where is the well-known principle of equality of sacrifice in this? The Finance Member in his budget statement of 1931 had said that these surcharges and the salary cut will go together, but he had partially restored the one and had held out full hopes of restoration in future before touching the other.

With regard to the incidence of taxation Sir George Schuster quoted Sir Walter Layton according to whom taxation in India was only about 6 per cent. as compared with 20 per cent. in Britain and Japan. But income also should be compared before coming to any conclusion. In this connection the Simon Commission pointed out that the average income per head in India in 1922 was less than £8, while the corresponding figure for Britain was £95. 'The contrast remains startling even after allowing for the difference in the range of needs to be satisfied.' (*Simon Commission Report*, Vol. I, Para 374.) It is thus clear that the lower proportion of a low national income may represent a very much heavier burden than a higher percentage of a high income. Further, the relative burden of taxation in different countries cannot be considered apart from the nature of the services rendered to the people by the Government in return for taxation. In Great Britain the expenditure per head on education is £2 15s. whereas in British India it is less than 9d. (*Simon Commission Report*, Vol. II, Para 238.) If, therefore, in England the burden of taxation is more than three times as much as in India, the amount spent on education is 75 times as much as in India.

With regard to relief in income-tax, he made a very vague statement and said, "As regards taxes on income...all that we can promise...is that they will not be continued longer than is necessary and that all our efforts will be directed to keeping down expenditure, and to preparing in other ways for a lightening of this particular burden." The continuance of the reduction of the taxation limit to one thousand and the

maintenance of the surcharges so far was highly undesirable. Taking into view the income per head, the Indian tax-payer should be said to be the highest taxed in the world. There was no justification for lowering the tax limit under the circumstances and their continuance for any length of time was improper.

The best way to balance the budget was to reduce the military expenditure. Sir George Schuster said that Sir Walter had wished it to be reduced to Rs. 48 crores in ten years, while the Government of India had reduced it to 46 crores within three years. That is true but firstly, Indians cannot accept as gospel truth the limit laid down by Sir Walter Layton and secondly, the reduction has not even been commensurate with the tremendous fall in the prices of commodities. The military expenditure of India in 1913-14 was 29.84 crores and there is no reason why it should not be immediately reduced to this figure. Taking into view the budget estimates for 1933-34 and the military expenditure for the same year, the figures are 124.52 crores and 46.20 crores respectively which means that more than one-third of the revenue is still spent upon the army or more than 50 per cent. is eaten away by the military and civil heads. Of course, an increase in public expenditure is not always a cause for regret and alarm and as the late Mr. Gokhale pointed out in his written evidence before the Welby Commission, 1897, 'everything depends in this matter on the nature of the purposes for which the increase has been incurred and the results produced by such outlay of public money.... While increased expenditure in other countries under popular control... has helped to bring increased strength and security to the nations, and increased enlightenment and prosperity to the people, our continually increasing expenditure has... only helped to bring about constantly increasing exploitation of our natural resources, has retarded our national progress, weakened our natural defences and burdened us with undefined and indefinite financial liabilities.' We must beware of making a fetish of military efficiency and remember that a very poor country like India cannot afford to spend so much on military as is being done by the Government of India.

The Finance Member made provision in the budget for war debts for the current year and for the next year amounting to £658,800. There was no need for making this provision when it was not known whether England would demand it that year or next year and when there was the possibility that Australia, South Africa and Canada would either not pay or express inability to pay the debt. The Finance Member pointed out that without this provision, it would have been unsound finance. But then, it is not clear why no provision

was made for India's reparation claims also. In this connection in reply to an interjection of Sir Cowasji Jahangir, Sir George Schuster remarked, 'Unfortunately one must suffer for being virtuous. We are good debtors while those who owe us may not be in a position to pay.' We are good debtors because the Government can levy taxation to any extent in utter disregard of Indian public opinion.

STAMP DUTY ON CHEQUES

A proposal was made for reimposing the stamp duty on cheques for a period of three years which was estimated to produce a revenue of about 7 lakhs for one year and a large part of the proceeds was likely to go to Bombay and Bengal. Happily this proposal was thrown out by the Assembly. This duty was abolished from the 1st July 1927 in response to the recommendation of the Hilton-Young Commission which wrote, "This charge is undoubtedly an obstacle in the way of the development of banking in the country. It probably tends to restrain many people from opening current accounts and so making payment by cheque instead of cash. This... might well prove an important factor in bringing about a profound and still more widespread change in the economic habits of masses." (Paragraph 216.) The Finance Member said that from enquiries made by the Government of India it was clear that it had not increased the use of cheques as a means of payment. '*The Report of the Indian Central Banking Enquiry Committee* tends to confirm this belief.'... This was a highly misleading statement as the Indian Central Banking Committee in very clear and unambiguous language said, 'Evidence is forthcoming from all directions of a substantial increase in the number of cheques which daily pass through the clearing houses. The recent abolition of the stamp duty on cheques appears to have contributed materially to a more extensive use of the cheque, not only in the Presidency towns and other big commercial centres, but also in the mofussil.' (Para 663.) In a subsequent speech he did admit that he was mistaken regarding the views of the Indian Banking Committee in this respect, but none the less persisted in holding that the cheque habit had not increased by the abolition of the duty. His contention does not deserve as much weight as the considered views of two expert commissions. This proposal would have been highly detrimental to the growth of banking habit in India and would also hinder the establishment of the Reserve Bank. (For details see my article in the *Leader* of Sunday, 26th March 1933, p. 8.)

GOLD EXPORT

The Finance Member supported the exports of gold which during the last fifteen months amounted to 107·04 crores.

He said that with the present level of merchandise exports India could not support the present volume of imports simultaneously with meeting her external obligations unless they were supplemented by the exports of gold. He claimed that it was beneficial for India to use these reserves which lay idle and did not bring any revenue. Against £ 80 millions worth of gold exported from September 1931 to the end of 1932, Government was able to purchase £ 70 millions, £ 10 millions being used to repay foreign loans temporarily invested in India. Out of the £ 70 millions Government used £ 34½ millions to meet its own current requirements and 35½ millions to repay sterling loans and strengthen its reserves. Out of the latter the Government used £ 15 millions in repaying the £ 5½ per cent. sterling loan maturing on January 1, 1932, added about £ 11 millions to its currency reserves and about £ 9¼ millions to its treasury balances. He also said that it implied the substitution of one form of hoards by another, namely, investments in Postal Cash Certificates and Savings Bank Deposits which were at the record figure of 10 crores and 4.35 crores respectively. It was also said that the Government could not possibly prevent the individuals from selling their gold at profitable rates outside India.

In connection with these arguments it may be said that to export gold in payment for imports is a dangerous way of living on capital and does not indicate the prosperity of the people, but their helplessness; because they have been able to keep the wolf out of the door only by the sale of gold. Secondly, if investments have increased, it is because the shrewd investor of the Indian money market could not invest his money in industries owing to business depression and this does not mean that the poor have been able to increase their investments. They have in fact nothing to invest. It is the cultivators who have been forced to part with 'distress gold' and by no stretch of imagination can it be said that they have invested their money in the Postal Cash Certificates and Savings Banks Deposits. Thirdly, the export of gold in payment of debts cannot be contemplated with equanimity. We never borrowed money in the form of gold and should not, therefore, pay those debts in gold. For paying only about £ 17 millions of the December instalment, there was so much agitation in England and India, therefore, cannot regard the factor with satisfaction. If the whole of our external debt is paid in gold, probably none of the yellow metal will be left in the country. Sir George Schuster was not voicing Indian sentiments when he said that even if three times as much gold more were exported as was done so far, we would still have more gold than we had 11 years ago. Further, the Government seems to be accumulating sterling securities in the reserves

contrary to the recommendations of the Hilton-Young Commission which laid down that the securities should be such the principal and interest of which should be payable in gold and sterling at present is not gold. The argument that by exporting gold, India has been able to take more imports and thereby increased the potential power of her own customers is no valid argument. America, France and England and specially the former two countries need this sort of sermon where in spite of large gold hoards in the vaults of banks, nothing is being done to improve the purchasing capacity of their potential customers. Moreover, to say that the Government could not do anything to prevent people from making profits by sales of gold is irrelevant because in 1919 there was an embargo laid on the exports of silver which could have been sold at very high prices in the Eastern markets, but this argument was not remembered at that time. Public memory is short and this fact was not referred to in the Assembly by the oppositionists. The same thing could have been done in the interests of the currency situation in the country at present. The Hilton-Young Commission was afraid of a very adverse effect of the purchase of gold by India upon the world markets; but in the past 15 months a golden opportunity came for the Government to purchase gold without disturbing the world money markets and they could do so if they had the will to do it. So long as retention of gold is the cherished ideal of the Central Banks in western countries and they allow only the inflow of gold and place restrictions on its outflow, India should also do the same. Gold cannot be regarded simply as a commodity except by the gold mining countries and India must do all that can be done to retain her gold resources.

The Finance Member referred to the extraordinary power of resistance of India when he said, 'In the first place, the results as regards imports combined with the figures of Indian production of such articles as salt, kerosine and cotton piece-goods seem to reinforce one of the points which I emphasized in my speech last year—namely, the extraordinary power of resistance in spite of diminished purchasing power which India shows in maintaining the consumption of certain standard necessities of the masses.' The Government may derive satisfaction from the fact that Indians are purchasing the same quantity of salt, kerosene and cotton piece-goods as before; but this statement cannot delude the Indian economists who know only full well that the standard of living of the masses in India has reached an irreducible minimum. Is it that the Finance Member could have been convinced of the miserable lot of the masses only if they could not afford to purchase even a commodity like salt? The growing unemployment, the sale of distress gold by cultivators and the miserable

economic plight of the masses coupled with the lowest pitch to which trade and industry have fallen in India at present are not, it seems, enough indications of the grim realities of economic conditions of India.

The budget should have been balanced by reduction in military and civil expenditure and by keeping the salary bill as low as possible and not by the maintenance of emergency taxation. This would have been real sound finance, but such a step could not even be thought of by the Finance Member. Our customs revenue has fallen and our railway receipts have gone down and with all emergency taxation measures remaining as before, the surplus of 217 lakhs shown in the revised estimates for the current year will be reduced to a surplus of 42 lakhs. *i.e.*, the situation has worsened by 175 lakhs. And still the Government refuse to realize that the Law of Diminishing Returns has begun to operate. In face of these facts the royal road to sound finance lies in reducing the expenditure and not in maintaining the abnormally high level of taxation which is killing initiative, enterprise and paralysing industry, trade and business. The duty of Indian economists is to offer safe and sound advice and its acceptance or rejection lies with the Government.

INDIAN BUDGET, 1931-35

Sir George Schuster, the Finance Member, gave a brilliant survey of the economic position of the country in his budget speech and outlined his main taxation proposals. In the Assembly the budget was styled as "distress budget", "deficit budget", "Bengal budget", "realistic budget", etc., by various members according to the light in which they viewed the taxation proposals. If one more epithet were pardonable, it might be styled as "disappointing proposals budget" or "extraordinary taxation budget".

According to the usual practice and procedure the Finance Member gave an analysis of the Actuals of the past year, Revised Estimates for the current year and the Budget Estimates for the ensuing year. In connection with the Actuals of 1932-33, it was pointed out that after providing 6,84 lakhs for Reduction of Debt, there was a surplus of 1,55 lakhs so that without taking into account Reduction of Debt, the excess of receipts over outgoings was 8,39 lakhs. The Finance Member said, "The net result is that over the two years combined we not only paid our way so far as budgetary income and expenditure is concerned, but in addition provided a sum of 3,53 lakhs for Reduction of Debt."

Turning to the Revised Estimates, the Finance Member pointed out that leaving out of account the Reduction of Debt provision, there would be a surplus of 4,29 lakhs. In the

Budget Estimates for 1933-34 a surplus of 25 lakhs had been expected after providing 6,88 lakhs for Reduction of Debt. The result was 2,84 lakhs less favourable than the estimates. This deterioration was caused by a drop of 5,04 lakhs on revenue partly balanced by a saving of 2,20 lakhs on expenditure.

The fall in revenue was due to the following items :—

(a) *A Deficiency of 4,38 Lakhs under Customs.*—The Finance Member pointed out that last year's estimates were based "on the assumption that the conditions of the previous year as regards exports and imports of merchandise would be repeated, subject to the allowance of a drop of about one crore in import duties to cover decreases in sugar import duty due to the growth of Indian production and in the cotton piece-goods duty where the figures for 1932-33 had to be regarded as abnormal. The results have proved that we did not allow enough for these changes." He expected 1,10 lakhs less on sugar and on the whole range of textiles, fabrics and yarn both, the actuals estimated were to be 2,67 lakhs less than the budget estimate and 3,63 lakhs less than the actuals for 1932-33. There was a falling off under a number of other heads also. It was pointed out that "the falling off in imports of sugar and textiles at least means that Indian producers have had a greater share in the home market, while as regards the general falling off in imports, this had been balanced by a substantial increase in exports and a satisfactory feature is that as a result of these changes India is moving back towards her normal favourable balance of trade in merchandise and is thus diminishing her reliance on gold exports in order to maintain an even keel."

(b) *Receipts from Income-tax* were expected to fall short of the estimates by 93 lakhs.

(c) *Interest and Currency and Mint Receipts* were down by 74 lakhs. This was counterbalanced by a windfall under the head of "Extraordinary Receipts" of 33 lakhs due to the repayment of a pre-War debt by the Persian Government.

The revenue position may be summarised as below :—

(+ = Better - = Worse)						
					+	-
Customs .. .. .	..	..	..	..	..	4,38
Taxes on Income ..	..	..	..	..	..	93
Salt .. .. .	..	..	..	..	..	20
Opium Receipts (gross)	..	..	..	..	39	..
Interest Receipts ..	..	..	..	..	..	23
Currency and Mint Receipts	..	..	..	..	..	51
Other Heads .. ..	..	..	..	..	82	..
					<hr/> 1,21	<hr/> 6,25
					<hr/> - 5,04	

EXPENDITURE, 1933-34

On the expenditure side a saving of 2,20 lakhs over the budget estimates of the previous year was due to two causes, firstly, the award of the Capitation Tribunal and secondly, the non-payment of 88 lakhs interest on war debt for which provision had been made in the budget.

PROSPECTS OF 1934-35

Coming to the prospects of 1934-35 the Finance Member was optimistic about conditions of trade and agricultural production. He said, "Speaking generally one may say that on the whole . . . agricultural conditions have been favourable and crop yields satisfactory . . . In the agricultural season which is now current or just completed there have been marked increases in the production of India's main money crops . . . and so far as export crops are concerned, the increased quantities seem to be finding a market." He thought that in all these respects conditions were such as warranted normal prosperity and that the only trouble had been the low level of prices. In this respect also the Finance Member was optimistic inasmuch as he pointed out that the disparity between the prices of primary agricultural products and of manufactured goods had become less during 1933 than previously. A more optimistic feeling in business centres than last year, 'while the recent steady increase in the goods traffic receipts on the railways and the improvement in our export trade figures' were referred to by him as encouraging signs.

A moderate recovery under certain heads of customs import duties over the revised figures for 1933-34 was anticipated by the Finance Member and an improvement of 20 lakhs in the jute export duty was allowed. In regard to certain items a reduction in revenue was anticipated. These items were : sugar in which case the revenue was $10\frac{1}{2}$ crores in 1930-31 while only 1,80 lakhs had been budgeted in the estimates for 1934-35. In land customs, only 35 lakhs had been provided showing a loss of 65 lakhs under this head as compared with the revised estimates for 1933-34. Regarding machinery a drop of 35 lakhs on the revised estimates of the current year was made. This means that it had been put at one crore. Including cigarettes these items accounted for a drop of 4,00 lakhs as compared with the revised estimates for the current year. "On all the other customs items combined we are budgeting for a net increase of 1,75 lakhs so that the net deterioration under customs as compared with the revised estimates for the current year is 2,25 lakhs." He pointed out that on the whole including income-tax, salt duty, opium receipts, etc., the total drop to be allowed for the revenue as compared with the revised estimates for the current year was 2,74 lakhs.

Coming to the prospects of the expenditure side the Finance Member said that strict economy in expenditure was being enforced. The continuance of the 5 per cent. cut in pay, reduction in the army budget, etc., were referred to by him in a tone of optimism and approbation. He referred to the fact that the net Defence Budget came down to 44.38 crores for 1934-35 and that the total net expenditure came down from 93.20 crores in 1930-31 to 76.61 in 1934-35 (estimates).

PROPOSALS FOR 1934-35

The main proposals for 1934-35 are as below :—

(1) *Sugar Excise Duty* at Re. 1-5-0 per hundred-weight which was expected to yield 1.40 lakhs.

(2) *Revised Duties on Tobacco and Cigarettes* which were expected to yield 30 lakhs.

(3) *Reduction in the Import Duty on Silver* from 7½ to 5 annas per ounce, net revenue expected to be 4 lakhs.

(4) *An Excise Duty on Matches* which was expected to yield 1.47 lakhs.

(5) *Revised Postal Rates* including :—

(a) A reduction in the initial weight of inland letters from 2½ to ½ tola coupled with a reduction in the charge from 1½ anna to 1 anna. In the first year, allowing for a recovery of 10 per cent. in traffic, it was expected to involve a loss of 27 lakhs in revenue.

(b) The remission of the extra pie per five pice embossed envelope.

(c) Revised postal rates on packets where the initial charge on inland book packets for the first 5 tolas had been increased from 6 pies to 9 pies.

(d) Revised charges for telegrams. A minimum charge of 9 annas for a telegram of 8 words had been fixed. This had necessitated a change in the case of express telegrams also for which the charges are double those of ordinary telegrams.

(6) *Abolition of the Export Duty on Raw Hides* expected to involve a loss of Rs. 5 lakhs.

(7) *Handing over half the Jute Export Duty* to the jute producing provinces which next year was expected to amount to 1.90 lakhs. About 1.67 lakhs was to go to Bengal, 12½ lakhs to Bihar and Orissa, and about 9½ lakhs to Assam.

(8) There was expected to be a net improvement in revenue of 1.69 lakhs which would cover the deficiency of Rs. 1.53 lakhs and leave a surplus of 16 lakhs.

HELP TO BIHAR

Out of the surplus of 4.39 crores for 1933-34 Rs. 3 crores was to be used for reduction of debt and Rs. 1.29 crores to be utilized towards creating a special fund for giving relief to

Bihar. The problem of reconstruction was treated under four heads :—

(a) *Firstly, Reconstruction of Government Buildings, etc.*—The cost of the construction of Government property was put at one crore, half of which was to be provided by the Government of India as capital expenditure on its own account. For the other half the Government was to make a loan to the Provincial Government through the Provincial Loans Fund.

(b) *Financial Help to Local Authorities.*—Secondly, the extensive damage to the property of local bodies was put at over one crore. “For all these purposes we propose to make a free grant from central resources, that is to say, from the special fund already mentioned which is to be formed out of this year’s surplus.” As the whole amount was not necessary all at one time, the Government provided in next year’s estimates for expenditure of only 75 lakhs on this account. The Finance Member assured the House that if more than this could be advantageously spent “we shall have no hesitation in providing the additional sum required.”

(c) *Assistance to Private Individuals.*—Thirdly, there was the question of assisting private individuals to rebuild their houses and shops. The poorest sufferers were to be provided with free grants from the various public relief funds, but the middle class people, who would not accept charity, were to be provided with loans through the Provincial Government at reasonable terms. He said, “At the moment all I can say is that we have every intention of making available to the Provincial Government, on terms that will not be onerous to them, or to those who are ultimately to receive the advances, whatever sum may be found to be needed for this purpose.”

(d) *Agricultural Problems.*—Fourthly, there was the agricultural problem and vast damage was done by the earthquake to agricultural land over wide areas of North Bihar due to deposit of sand. The balance held by the Bihar Government in their Famine Relief Fund could be properly regarded as available and beyond this the Provincial Government was assured of the Central Government’s financial support in any further action. “But some portions at any rate of the cane cannot be dealt with in this way, and the Provincial Governments are, therefore, providing the country mills and other equipment, in order to convert it into *gur*. We have informed them that we are prepared to bear the whole cost of this measure from central revenues : it will probably not exceed five lakhs.”

Regarding the borrowing programme for 1934–35 the Finance Member said, “We have already dealt with all the loans the maturity dates of which afford us an opportunity of converting them. The only securities actually maturing for repayment next year, are the 4½ per cent. bonds of which 12,98 lakhs have

already been converted during the current year, leaving a balance of 13,00. In England there is nothing. If we allow for receipts of 11,50 lakhs from the Post Office Cash Certificates and Savings Bank deposits as against 16,90 during the current year, this will mean that after taking into account the 2.85 million balance of $3\frac{1}{2}$ per cent. sterling loan which has still to be paid up, we will not require to float any regular loan either in India or in England. . . . We have two large loans which we have the option to repay in London in 1935 and 1936 amounting to £ 29 millions or nearly 40 crores. We have also the 4 per cent. loan 1934-37 in India amounting to 19,54 lakhs, the 5 per cent. 1935 Bonds amounting to 11,43 and the $6\frac{1}{2}$ per cent. Treasury Bonds also payable in that year amounting to slightly over 16 crores which it may be possible to convert if conditions are favourable." It was also pointed out that though the position was strong in respect of sterling reserves, they would be further fortified if conditions were favourable. The rupee treasury bills in the Paper Currency Reserve might be replaced by sterling securities and a corresponding increase in public borrowings might be necessitated. The budget provided for 30 crores outstandings of treasury bills held by the public for the subsequent year.

GENERAL COMMENT

Concluding his survey the Finance Member said, " India's financial position in its strength challenges comparison with that of any country in the world. In these times of increasing economic nationalism, there is no country that has brighter prospects or greater potentialities for economic advance than India with her own vast market and with her place in the British Commonwealth of Nations." It should be said that the Finance Member depicted a much too brighter condition of India's economic position than was actually warranted by facts. There might have been brighter prospects or greater possibilities for economic advance in India than in other countries, but the actual economic prosperity was far less probably than in other countries taking into view the amenities provided and services rendered by the State.

During the previous five years, abnormal taxes amounting to about 45 crores were imposed but it cannot be said that there had been a proportionate increase in economic prosperity. Was there a *pro tanto* increase in the amount of money spent on education, sanitation, public health, social insurance, etc.? In other countries the State is spending a very large sum of money on social insurance. According to the *World Economic Survey* for 1932-33, " The number of workers covered by compulsory insurance schemes has been estimated by the International Labour Office as over 38 millions, with a further

three and a half millions covered by voluntary schemes . . . , in general, the funds are derived from contributory systems in which the State subsidises the contributions of workers and employers. The increased payments caused by the depression, together with shrunken receipts, have necessitated an increase in State subsidies or advances in most compulsory insurance schemes."

"Despite the strain thrown on the funds and the heavy burden of supplementary relief, the principle, not only of unemployment, but of other forms of social insurance, is stoutly defended and seems to have won ground—for example, in the United States. The State of Wisconsin has already adopted legislation for this purpose, and it seems certain that more comprehensive legislation will be initiated in the near future." (Pp. 113, 114.)

In the United Kingdom expenditure out of the unemployment fund was £ 51 million during the year 1924-25, of which 28.3 per cent. was contributed by the State. In 1931-32, the total had risen to £ 120 million, of which 72 per cent. was contributed by the State. These sums were in addition to the heavy burden carried by the local authorities. In Germany in 1931, the expenditure on unemployment relief was R.M. 2,331 millions, of which 38 per cent. was borne by Federal and State Governments. In the Netherlands, unemployment expenditure rose to 24.9 million florins in 1931 from 5.2 million florins in 1924, of which 32 per cent. was borne by the Government. In Switzerland the figures rose from 1.6 million francs in 1924 to 37.9 millions in 1931, of which 84 per cent. was borne by the public authorities. Thus it is clear that the relative pressure of taxation in different countries cannot be considered apart from the nature of the services rendered by the State to the people in return for the taxes levied. In India the Government turned down the proposal for social insurance on grounds of economy. There is no system of old age pensions, social insurance, etc., in India as compared to other countries. Even statistics of unemployment are not compiled in any scientific manner and thus the extraordinary increase in taxation, amounting to about 45 crores during the last five years, does not seem to have implied a corresponding increase in services rendered by the State like those in countries named above.

EXCISE DUTY ON MATCHES

The Finance Member made a proposal to levy excise duty on matches to the extent of Rs. 2-4-0 per gross of boxes to enable the Government to give half the jute export duty to the jute-producing provinces. The proceeds of this duty would be pooled in a common fund and divided among the States and

provinces on consumption basis. The States would also be invited to levy in their own territory excise duty on matches.

The Match Excise Duty Bill was referred to a Select Committee which recommended an excise duty of Re. 1 per gross of boxes containing on an average 40 matches. The Select Committee write, "We hold that the duty should be at the corresponding rates for matches in boxes of 60 and for matches in boxes of 80 and that classification of matches according to these standards is most suitable and convenient from the administrative standpoint." Rebate was recommended for the cottage industry in response to the recommendations of the Tariff Board, *vide* paragraph 136 of the latter's report.

The dissentients objected to the recommendations of the majority on the following grounds :—

Firstly, "All the Indian States having match factories within their territory have not yet consented to enter into an agreement with the Government to pay into a common pool the proceeds of the excise duty which they would collect from their States. Such States as do enter into agreement are to receive back from the common pool an amount calculated on the population basis." This is not regarded equitable because the difference in standards of living in British India and Indian States is considerable and the consumption of matches in British India must be greater than the ratio of population. "The States in India which have no match factories within their territory are going to be allowed to enter into agreement with the Government whereby they are to get their proportionate share of the excise duty from the very start in return for the undertaking that they will levy the excise duty when a match factory or factories are constructed in their States."

Secondly, "The excise on matches to be collected in all units of the Federation was considered to be one of the most valuable sources of revenue for the future Federal Government. If all the States are to be given the privilege of sharing this revenue immediately, it will be most difficult in future to get them to give it up for the benefit of the Federal Government."

It may be said that the match excise duty would penalize the consumer or neutralize protection to a certain extent and thus retard the development of the growing nascent match industry.

SUGAR EXCISE

The Finance Member proposed a duty of Re. 1-5-0 per hundred-weight which according to his estimates would give an yield of Rs. 1,47 lakhs. Out of this one anna per hundred-weight amounting to about 7 lakhs would be distributed among the sugar-producing provinces to form a fund for the purpose of

assisting the organization and operation of co-operative societies among the cane growers to help them in securing fair prices, or for other purposes directed to the same end.

The Finance Member pointed out that the Tariff Board had recommended a basic import duty of Rs. 7-4-0 per hundred-weight and that with the surcharge of Re. 1-13-0 the duty was Rs. 9-1-0 per hundred-weight. This would leave a margin of Rs. 7-12-0 per hundred-weight which he considered adequate. This was designed to prevent over-production, to give the cane growers a sufficient advantage and to get adequate revenue for the country. He said, "We trust, however, that as a result of the legislation which we propose to introduce, the immediate position of the cultivators would be protected, while taking a view of the more distant future we have been compelled to the conclusion that if the present conditions are allowed to continue there is a danger of over-production which might, in the long run, bring disaster to the interests of cultivators and manufacturers alike. We believe that the measure of protection which will remain is sufficient to allow all reasonably well-organized factories a fair margin of profit after paying a fair price to the cultivator, and here again we feel that in the long run the industry will enjoy a more healthy life and growth if this change is made now than if the present excessive duty is allowed to continue."

It may be pointed out that the majority of the Select Committee to which the Sugar Excise Duty Bill was referred recommended a reduction of duty to Re. 1 per hundred-weight. The Majority wrote, "We have reduced the rate of duty proposed by the Bill to the rate of Re. 1 per hundred-weight upon sugar generally and the rate of 10 as. per hundred-weight on Khandsari sugar. Although we recognize that the difference between import duty *plus* surcharge now in force, Rs. 9-1-0 and excise duty, Rs. 1-5-0, proposed on the original Bill amounting as it does to Rs. 7-12-0 per hundred-weight, represents the maximum duty recommended by the Tariff Board and accepted by the legislature as measure of protection, we are not satisfied that the preservation of difference in this manner will produce exactly the same effect as measure of protection promised. We are also apprehensive that the imposition of an excise duty of Re. 1-5-0 may in the early stages of the development of the sugar industry prove unduly onerous and check the development. On the other hand, we consider that a duty of Re. 1 may be safely imposed. Our reduction of rate of duty to be payable on Khandsari sugar is prompted by consideration that there is a lower margin of profit in the case of sugar made by factories working by the Khandsari process and that such sugar is accordingly less capable of shouldering the proposed duty."

The Minority consisting of the Government members did not agree and pointed out that "We feel, therefore, that the case for the Government proposal has in no way been shaken and that a reduction of duty to Re. 1 is purely an arbitrary proposal based on no careful examination of what the industry can stand. Apart from the above considerations which induce us to support an excise duty of Re. 1-5-0 on its merits, we must point out that a reduction to Re. 1 would entail a loss of about Rs. 34 lakhs in 1934-35 or Rs. 38 lakhs on full year's working at the estimated rate of Indian production for 1934-35. As the Indian production increases the loss will, of course, increase. Such a change would, therefore, disturb the whole financial plan on which the Budget was framed with its proposal for transfer of half the jute export duty to Bengal and other provinces."

"We consider that Government should be under an obligation not to do anything without the approval of the legislature to vary their declared policy of maintaining difference between the import and excise duties at the level recommended by the Tariff Board. If the excise duty were to be reduced to Re. 1 then the difference would be in excess of this level even in the present conditions when the selling price of Java sugar justifies an additional margin of eight annas. We consider that the Government should be free to reduce this difference to that recommended by the Tariff Board without bringing the excise legislation under review."

It may be pointed out that the Sugar Excise Duty Bill as originally proposed by the Government was passed by the Legislative Assembly and the proposal of the Majority of the Select Committee which was styled by the Minority as "purely an arbitrary proposal based on no careful examination of what the industry can stand" was rejected.

A grave injustice was done to the Indian sugar interests by the passage of the Sugar Excise Duty Bill and by fixing the excise duty at Re. 1-5-0 per hundred-weight.

BASIS OF PROTECTIVE DUTY

There was some misunderstanding about the recommendations of the Tariff Board regarding the basis of protection to the sugar industry. The protective duty that was recommended by the Tariff Board was Rs. 7-4-0 per hundred-weight on the imported sugar on the calculation that Java sugar at the ports would be sold at Rs. 4 per hundred-weight. It was also assumed that the price of Indian factory-made sugar would be Rs. 8-12-0 per maund in the beginning of protection period and that molasses would fetch Re. 1-8-0 per maund. Molasses fetch nothing and are becoming a liability for factories. It is, therefore, possible

that some factories may have no option but to close down not because of any inherent inefficiency in the beginning, but because of a penalty imposed by the excise duty. The internal competition has resulted in a lowering of prices and a decrease in profits.

Indian sugar cannot withstand competition of Java sugar. Java is supposed to have a large store of sugar and the imposition of the sugar excise on Indian sugar industry is likely to give some advantage to Java sugar. Further, if Java goes off the gold standard conditions will become highly unfavourable for the Indian industry and possibly the Government of India might then have to bring into operation the Safeguarding of Industries Act.

Much has been said about the high profits made by the sugar concerns. Profits have been made by the older-established concerns which have been able to survive the lean years and if an average were struck, it will not show a higher rate of return on capital than in other industries.

The Finance Member pointed out that the excise duty would check over-production which was rampant in India. It is the internal competition and not the excise duty which is a better remedy for over-production if it really exists and it was therefore unnecessary for the Government to interfere with the inexorable economic law to check over-production. Granted that there was or is a tendency to over-production the question is whether an excise duty is the real remedy. In other countries this device is not followed to check over-production. The surplus produce could have been sent to other countries. The remedy for over-production is not a curtailment of production, but to find out new markets and to develop the purchasing power of the people to consume more sugar. In place of pursuing these remedies, the Government had chosen to penalize the industry. If really there was over-production, why should the Finance Member estimate that one lakh tons of Java sugar would come into India? If there was no over-production, the excise duty would check the expansion of the industry to the full requirements of the country.

The cane grower would lose much. He can get better prices from sugar factories in the absence of handicaps like the excise duty than if the latter are in operation. In the Tariff Board Report it was laid down that the sugar industry included the cane grower, the manufacturer of *gur* and of all other indigenous forms of raw sugar, as well as the manufacturer of white sugar. All these branches of industry use about 50 million tons of sugarcane annually, and of that quantity, about 6 million tons are crushed in white sugar factories. Any disadvantage to the factories would also react unfavourably on the cane growers.

A section of the Minority of the Select Committee do not accept the statement of the Finance Member that a reduction in duty would lower the estimated revenue. They write as follows :—

“ The Finance Member estimated that he would get Rs. 1,47 lakhs by imposition of this excise duty at Re. 1-5-0 per hundred-weight. We consider this to be an under-estimate. Owing to the growth of new factories in the current year we estimate that at least 7,50,000 tons of sugar will be produced as against the Government estimate of 6,48,000 tons. Moreover as the Government estimate did not include Khandsari sugar which amounts to nearly 2,50,000 tons and of which at least 60 per cent. is produced by factories, the total amount of revenue at Re. 1-5-0 per hundred-weight would come to Rs. 2,36,25,000. In a taxation measure it is the duty of the legislature to see that no more revenue is granted than is asked for by the Government.”

“ We find even on the basis of Re. 1 that Government would get at least Rs. 1,47 lakhs that they have budgeted for. Increase in the initial production of sugar has an obvious bearing on the imports of sugar. But the Finance Member has estimated this year's imports to be only 110,000 tons as against the imports of 330,000 tons during the last year. There is no possibility of the estimated figure of imports being reduced owing to increased internal production particularly in view of the fact that due to imposition of excise duty the competitive conditions will be keener and that, as estimated by the sugar technologist, consumption of sugar will also be larger.” It is thus clear that the duty as passed by the Assembly was unnecessarily high.

ASSISTANCE TO BENGAL

The proposal to give financial assistance to Bengal on the ground that “ it has been recognized in the White Paper and the Government of India is also prepared to accept a similar conclusion” was unjustifiable on principle. Further, merely because Bengal has been incurring deficits at the rate of about 2 crores annually is no ground for taxing the general tax-payer. It is a premium on inefficiency, extravagance and unsound finance, and this is bound to arouse inter-provincial jealousies. This is a bad precedent and on this principle Burma deserves half the rice export duty, Assam half the oil export duty and the sugar-producing provinces half the sugar excise duty.

The budget would really have been a deficit budget but for the raid on the Debt Redemption Fund. There was still a very great possibility of reduction in the military expenditure. The demand under the defence head, for next year was Rs. 44.38 crores. The expenditure on education, health and medical services is very small. In 1929-30 the defence expenditure alone

was 55 crores, law and order, justice, etc., 27 crores and pensions 7 crores. Education accounted for 13 crores and health and medical services $6\frac{1}{2}$ crores. (*Indian Statutory Commission Report*, Vol. II, p. 215.)

The views of the Indian Statutory Commission on military expenditure burden in India may be quoted below :—

“ An outstanding feature of this summary is the high proportion ($62\frac{1}{2}$ per cent.) which current expenditure on defence bears to the total expenditure of the Central Government—a higher proportion in fact than in any other country in the world. It is more significant that even when account is taken of provincial and central expenditure together, the ratio ($31\frac{1}{2}$ per cent.) is still a very high one. This ratio is high in part because other kinds of expenditure are low.

“ Security is, of course, essential, if production is to develop, but it cannot be claimed for expenditure on defence either that it is a mere redistribution of income or that it promotes productive efficiency. Indeed, economically speaking, it is the most burdensome form of expenditure, and this is particularly the case where, as in the case of India, the army contains a large element drawn from elsewhere. If, therefore, the high “defence ratio” in Indian Government expenditure is partly due to the low level of other expenditure, it remains a peculiarly burdensome one.

“ But apart altogether from the question of other forms of expenditure in India, the defence charge is undoubtedly high. A recent comparison of the military expenditure of the nations of the world shows that in this respect India is seventh on the list among the Great Powers and that her expenditure on armaments is between two and three times as great as that of the whole of the rest of the Empire outside Great Britain. Again, the total is not only high in itself and as compared with other countries, but it has also greatly increased as compared with the pre-War situation. India, in fact, has not obtained any relief from the greater sense of world security, which has succeeded the World War. On the contrary her defence expenditure has risen even after allowing for the rise in prices and has grown more rapidly than in other parts of the Empire. This is apparent from the following figures :—

ARMAMENT EXPENDITURE

(In million £)

		1913	1928	Percentage Increase
Great Britain	.. ..	77.2	115	+ 48.9
India	.. ..	22.0	44	+ 100.0
The Dominions	.. ..	9.0	12	+ 33.0
TOTAL	.. ..	108.2	171	+ 58.33

“ Finally, it is frequently urged that expenditure for the defence of India is not a matter that concerns India only, but is also one which is of vital importance to the Empire as a whole and should, therefore, not be at the sole charge of India..... But it is relevant to my present purpose to point out that the total is at present so large, both absolutely and in relation to the revenue of India, as to be a dominating factor in the financial situation.” (Pp. 216–218 of the *Report*.)

These facts are self-evident and no comment seems to be necessary. The price-level at present is far lower than in the pre-War period; but the military expenditure has not been brought down to the pre-War level which means that nation-building departments are bound to be starved unless there is considerable reduction in the expenditure on defence.

The reduction in postal charges is to be welcomed, but it is not as much as it should have been. There should have been a reduction in the price of the postcard also.

The Finance Member challenged the statement on the floor of the Indian Legislative Assembly that the Law of Diminishing Returns was operating regarding the taxes in India and pointed out that this term had been most abused during the last two or three years. It may be said that the reduction of postal rates in certain cases as effected by the Government is a proof of the prevalence of the Law of Diminishing Returns. Let the price of the post card also be reduced and the yield will increase in course of time. The fall in customs and income-tax of 4.38 crores and 93 lakhs respectively was another proof of the operation of the Law of Diminishing Returns.

It was also pointed out by the Finance Member that scientific taxation would necessitate an increase in taxation which would fall on the masses, but that it would not be liked by the House. Increase in indirect taxes would not be bad provided the masses have the capacity to bear them and provided the proceeds are spent in a way that is most conducive to economic welfare.

The need of the hour is to increase the purchasing power of the people by industrialization and this is not possible unless the Government frame the budget from a different angle of vision. This is done in India primarily with reference to the expenditure side which penalizes industries. Unless this policy is changed industrialization cannot increase at an adequate pace.

INDIAN BUDGET, 1935–36

The Indian budget for the year in question was balanced with a surplus; while there was some remission in taxation and the pay-cuts were restored. The Finance Bill as moved by the Finance Member was modified in the Assembly, but the

Government ignored the vote of the House and the Governor-General used his extraordinary powers to certify the Bill. The main features of the Indian Finance Bill as originally moved by the Finance Member and eventually enacted as an Act for the ensuing year were as follows :

1. Reduction by one-third of surcharges on income-tax and super-tax ;
2. Reduction of duty on silver from five annas to two annas an ounce ;
3. Abolition of export duty on raw skins ;
4. Extension of additional import duty on salt for one year.

The revised budget figures for the year 1934-35 were :— Revenue 91 crores, expenditure 87.73 crores, surplus 3.27 crores. The revised figures were better than budget figures by 3.17 crores. The budget figures for 1935-36 were :— Revenue 90.19 crores, expenditure 88.69 crores, surplus 1.50 crores. The accrued balance of 3.89 crores left over from previous years was allocated by setting aside one crore for provincial rural development schemes ; forty lakhs for Road Development Fund Reserve ; twenty-five lakhs for North-West Frontier Roads ; and twenty lakhs for rural broadcasting.

These schemes left a balance of 2.04 crores, a part of which was set apart for the civil aviation programme and the transfer of the Pusa Institute to Delhi ; while the remainder amounting to 75 lakhs was earmarked as an additional allotment for debt redemption.

The figures for the three financial years may now be examined. According to the budget of 1934-35, the revised figures for 1933-34 were expected to give a surplus of 1.29 crores ; while the actual figure came to Rs. 2.72 crores. The main causes of this improvement were :—

1. An unusually large number of holders of Government Securities failed to draw their interest ;
2. Recoveries from commercial departments were larger than expected ;
3. Forestalling in anticipation of an increase in the salt duty ; and
4. The non-realisation of the expectations of a reduction in income-tax receipts in the areas affected by the earthquake of 1934.

FINANCIAL YEAR 1934-35

The revised forecast for the year showed a material improvement over the original budget estimates and the surplus came to Rs. 3.27 crores instead of 10 lakhs. The revenue improved to the extent of 3.87 crores ; while the expenditure deteriorated to the extent of Rs. 70 lakhs.

The actual figures, excluding railways, may be stated as below :—

					<i>(in lakhs)</i>	
					Budget 1934-35	Revised 1934-35
Revenue ..	..	..	..	..	87.13	91.00
Expenditure ..	..	..	..	..	87.03	87.73
Surplus ..	..	..	..	..	.10	3.27

The surplus on the revenue side may be explained by the fact that Customs contributed a good deal to improving it, the principal items being :—

					<i>(in lakhs)</i>	
Sugar ..	..	..	..	..	1.38	net.
Cotton fabrics ..	..	..	..	..	.90	
Yarn and textile fabrics other than silk ..	..	..	..	..	.80	

There were also increases under motor cars, machinery, petrol and kerosene, offset by decreases in the export duty on jute and rice and in the excise duty on matches, the actual figure for the export duty on jute being 3,40 lakhs as compared with the budget estimate of Rs. 3,80 lakhs. The other item on the revenue side requiring special mention is Interest. In this connection, the head disclosed an increase of Rs. 26 lakhs only, which was made up of a considerable reduction of rupee, combined with a somewhat greater increase of sterling receipts. The latter was due to increased sterling balances; while in the case of the former the Government remitted the instalments of interest payment on the loans granted to Bhawalpur State.

The expenditure increased by Rs. 70 lakhs mainly because of the allocation to Bengal, Bihar and Orissa and Assam of a larger share of the proceeds of the jute duty than was originally provided for, the revised figures being :—

					<i>(in lakhs)</i>	
Bengal ..	..	..	..	..	149.3	
Bihar and Orissa ..	..	..	..	..	11.2	
Assam ..	..	..	..	..	8.5	

It was because originally the match excise was expected to be less than the estimates for 1934-35, that the jute producing provinces could not be promised the full amount of assistance originally proposed. The final estimates were accordingly based on the assumption that those provinces would be given only one-third instead of one-half of the total receipts from the export duty on jute. It was, however, made clear that in case the budget as a whole should turn out better than was then anticipated, the Government would be prepared to increase this proportion to one-half. Hence the position explained above regarding the increase in the expenditure due to the allocation of the jute export duty.

The position regarding posts and telegraphs may be stated as below :—

				(in lakhs)	
				Budget	Revised
				1934-35	1934-35
Gross receipts	..	..	..	70	98
Interest charges	..	..	..	84	84
Balance	..	..	..	-14	14

The year would thus close with a surplus of Rs. 14 lakhs as compared with a deficit of Rs. 14 lakhs which was originally anticipated. Apparently, the Department which, since 1927-28 had been working at a loss, was expected to show a surplus for the year in question, but the Finance Member explained that the position was not so satisfactory as it looked ; because the Depreciation Fund was drawn upon to the extent of Rs. 27 lakhs.

FINANCIAL YEAR 1935-36

The final position for 1935-36 is as follows :—

				Crores
Revenue	..	..	..	90.19
Expenditure	..	..	..	88.69
Surplus	..	..	..	1.50

Coming to details, it may be said that the revenue is 81 lakhs less than the revised estimate for 1934-35. The most important head is "Customs," the estimate for which is Rs. 51.92 lakhs altogether or an increase of Rs. 75 lakhs over the revised estimate for 1934-35. The main variations are a decline of Rs. 2 crores in the import duty on sugar together with increases of Rs. 35 lakhs on the sugar excise, of Rs. 65 lakhs on the match excise and of Rs. 43 lakhs on kerosene and petrol. The Finance Member did not expect, and rightly so, that the import duty would remain in 1935-36 at the level of 1934-35 and the increased revenue from the excise duty would not compensate for this decrease. When Indian production reaches its full level, imports of foreign sugar for ordinary consumption would almost disappear. The process might not be completed during 1935-36 and the figures estimated for import revenue and excise yield are Rs. 1.75 lakhs and Rs. 1.50 lakhs respectively.

Under the head "Income tax" the improvement estimated was at Rs. 57 lakhs, the actual figures being Rs. 17.76 lakhs for 1935-36 and Rs. 17.25 lakhs for 1934-35. Under the head "Opium," the estimate was Rs. 61 lakhs as compared with Rs. 71 lakhs for 1934-35. The interest head showed a large reduction amounting to Rs. 1.29 lakhs.

EXPENDITURE

Expenditure as a whole excluding railways came to Rs. 88,69 lakhs, showing an increase of Rs. 96 lakhs caused by the restoration of pay-cut. Minor increases on new schemes, *e.g.*, the marketing scheme, grants to the handloom and sericultural industries, etc., should also be held responsible for the increase. The defence expenditure shows an increase of Rs. 7 lakhs over the original estimate for 1934-35, excluding the pay-cut. The budget expenditure, actual or estimated, may be compared for the years 1931-32 and onwards and to get a fair basis of comparison, the provision for debt reduction and avoidance is deducted and the figures for Interest, Posts and Telegraphs and Defence are net. The position is then as below :—

1931-32	1932-33	1933-34
Actual	Actual	Actual
88.78	80.59	75.97
1934-35	1934-35	1935-36
Budget	Budget	Budget
	Revised	
78.12	78.50	80.06

The lowest year was 1933-34 excluding Rs. 2,72 lakhs transferred to the earthquake fund. The estimate for 1935-36 shows a net increase from this level of Rs. 4,09 lakhs. Of this, Rs. 1,79 lakhs is due to the grant of a share of the jute duty to Bengal, Bihar and Orissa and Assam, Rs. 1,30 lakhs is due to the increased provision for bonus on Cash Certificates and Rs. 1,08 lakhs represents the cost of restoring the 5 per cent. cut.

Regarding gold exports, it may be said that for the 10 months ending on January 31, 1935, the figures were approximately 41 crores as against Rs. 42½ crores for the corresponding period of the previous year. The Finance Member in this connection said, "I do not propose to discuss, at length, the arguments which have been advanced in favour of restricting these exports, but I take this opportunity of saying that I cannot share the views which attribute to them some abstruse monetary significance, nor do I find in them an indication that India is being driven by distress to part with her last reserves. Indeed, I can see no sufficient reason for placing them in a different category from exports of any other commodity of which India has a surplus, and I, therefore, find no cause for regret or alarm in the fact that India is still able to obtain so handsome a profit from the reserves of gold which had been accumulated in previous years." Notwithstanding this argument, it is true that the continued gold exports show that the country is living on its capital, which is not a healthy sign.

The surplus of Rs. 3,89 lakhs left over from previous years and that of Rs. 1,50 lakhs estimated for 1935-36 were proposed to be spent in the following manner. The former being non-recurrent could be made available only for non-recurring purposes; while the latter represented the maximum limit of sums which could be devoted to tax reduction during the year 1935-36. Thus out of the non-recurrent balance of Rs. 3,89 lakhs, a sum of rupees one crore was set aside for distribution to the provinces to be spent on schemes for the economic development and improvement of such areas. Out of this one crore, about rupees ten to fifteen lakhs is to be earmarked for the development of the co-operative movement and as regards the remaining sum of Rs. 85 to 90 lakhs, the same is to be distributed on the basis of rural population subject to the following conditions:—

1. That the grant should be spent on schemes approved by the Government of India which would improve the economic condition of the people; and

2. That it would be devoted only to schemes which the Local Government would not otherwise have been able to undertake in the immediate future. The money need not all be spent, however, immediately or during the year 1935-36.

A special contribution of Rs. 40 lakhs was proposed to be made to the Government of India's Reserve in the Road Development Fund; whereas a further sum of Rs. 25 lakhs was to be set aside for schemes of development in the North-West Frontier Province. A provision of Rs. 20 lakhs was also made for the development of broadcasting. The civil aviation programme was to have Rs. 93 lakhs and a sum of Rs. 36 lakhs was provided for the scheme of transferring the Pusa Institute to Delhi; whereas the surplus of Rs. 75 lakhs would go as an additional allotment for the reduction of debt.

The sum of Rs. 1,42 lakhs was utilised for providing relief in two directions; firstly, in the restoration of the 5 per cent. salary cut; and secondly, in taking off the surcharges on the income-tax. The surcharges have been removed by one-third and this left the Government with a nominal surplus of 6 lakhs.

The Opposition made certain amendments to the Finance Bill, which the Government ignored; and the Viceroy recommended the reconsideration of the Finance Bill to the Assembly in its original form, which the Assembly rejected. In course of time, the Viceroy certified it.

Certain comments have already been made on the budget and now they may be restated in a summary form.

Firstly, the allotment of rupees one crore for rural development schemes and the reduction in surcharges should be

welcomed, although the sum of one crore of rupees for rural economic development is very insignificant, while the reduction in surcharges on income-tax cannot be said to be adequate.

Secondly, the statement relating to gold exports is not convincing.

Thirdly, certain of the amendments carried out by the Assembly should have been accepted.

Fourthly, the speech of the Finance Member did not make any reference to the acute problem of unemployment calling for an adequate and immediate treatment.

Finally, as usual, the Finance Member failed to take account of the poverty of the Indian masses. The military expenditure has eaten up the largest part of the revenue, while much of the remainder is taken away by the civil and other services.

INDIAN BUDGET, 1936-37

It is gratifying to note that in the Budget for 1936-37 the overdue relief in taxation was announced by the Finance Member. The income-tax on incomes up to Rs. 2,000 was abolished and thus the exempted limit came up to Rs. 2,000. The surcharge on income-tax and super-tax was halved or reduced to a third of the original surcharge. With regard to postal charges, there was an increase in the weight of one anna letter from one-half to one tola and for every additional tola, the charge will be half an anna.

The relief to the tax-payer was delayed so long because the revenue was grossly under-estimated both in 1934-35 and 1935-36. It is possible that the rate of economic recovery would have been greater, if the income-tax had been reduced in 1934-35. Last year the Finance Member estimated that the final accounts for 1934-35 would disclose a surplus of Rs. 3,27 lakhs; whereas the actual surplus for the year amounts to Rs. 4,95 lakhs.

FINANCIAL YEAR 1934-35

Last year the surplus for the year 1934-35 was estimated at Rs. 3,27 lakhs; but the actual figure comes to Rs. 4,95 lakhs, or it means an excess of Rs. 1,68 lakhs over the revised forecast of last year. This was due to the following:—

- (1) An increase of Rs. 1,50 lakhs in Customs and Excise;
- (2) An excess of Rs. 30 lakhs on Income-tax;
- (3) An excess of Rs. 24 lakhs on Posts and Telegraphs;
- and
- (4) An excess of Rs. 19 lakhs on Currency and Mint.

These were partially counterbalanced by a fall of Rs. 55 lakhs on salt. The decrease in salt was attributed to a postponement of clearances at the end of 1934-35; while the increases under the heads, according to the Finance Member,

pointed to one cause, namely, that the recovery in India's economic position had set in more strongly than could have been foreseen a year after. Under the Customs and Excise heads, the increases were on imported and on indigenous kerosene, improvements in the yield of the export duties on jute and rice, an improved yield from matches and high seasonal importations of cotton fabrics, raw cotton and machinery.

Last year, it was decided to devote the surplus of Rs. 3,27 lakhs to various non-recurring objects, including a crore for constituting a Fund for the Economic Development and Improvement of Rural Areas. There was then a surplus of Rs. 13 lakhs. The whole of this unallotted surplus was proposed to be transferred to the Rural Development Fund. Thus, the transfers to the Fund would amount not to Rs. 1,13 lakhs but to Rs. 2,81 lakhs. Out of this Fund, Rs. 15 lakhs were allocated for the improvement of the Co-operative Movement and Rs. 92½ lakhs for grants to provinces, thus leaving in the Fund a balance of Rs. 1,73½ lakhs.

FINANCIAL YEAR 1935-36

The revised forecast anticipated a surplus of Rs. 2,42 lakhs instead of a surplus of Rs. 6 lakhs. This surplus was the result of an improvement of Rs. 3,53 lakhs in revenue, offset by an increase of Rs. 1,17 lakhs in expenditure. The actual figures are given below :—

				(Rs. Lakhs)	
				Budget	Revised
				1935-36	1935-36
Revenue	..	..	..	82,99	86,52
Expenditure	..	..	..	82,93	84,10
Surplus	..	..	..	6	2,42

These items are net and exclude railways altogether and they may now be analysed. The Revenue side shows an excess of Rs. 3,53 lakhs made up as below :—

1. An improvement of Rs. 1,85 lakhs on import duty on sugar ; and

2. An improvement of Rs. 1,68 lakhs under all other heads.

The increase in expenditure is made up as below :—

				(Rs. Lakhs)	
1. Extraordinary payments	41½
2. Interest	24
3. Currency and Mint	10
4. Miscellaneous Adjustments	9
5. Civil Administration, etc.	32½
					117

POSTS AND TELEGRAPHS

The position of Posts and Telegraphs may be summarised as below :—

		(Rs. Lakhs)	
		Budget 1935-36	Revised 1935-36
Gross Receipts	..	11,33	11,50
Working Expenses	..	10,62	10,64
Net Receipts	..	71	86
Interest Charges	..	84	80
Balance	..	—13	6

It is thus expected that the current year of the Indian Budget will close with a surplus of Rs. 2,42 lakhs, instead of the estimated surplus of Rs. 6 lakhs according to the Proposed Estimates for 1935-36.

FINANCIAL YEAR 1936-37

The position for the year 1936-37 may be summarised as below :—

		(Rs. Lakhs)
Revenue	..	87.35
Expenditure	..	85.30
Surplus	..	2.05

The Revenue side shows an improvement of Rs. 83 lakhs over the Revised Estimates for the current year; while there is shown an increase of Rs. 1,20 lakhs on the expenditure side. The details of the Revenue side are as follows :—

Customs.—Under this head, the receipts are estimated at Rs. 54,82 lakhs. This figure presumes a deterioration of Rs. 1,60 lakhs under the sugar import duty and an all-round improvement of Rs. 1,71 lakhs under other heads. There are three elements in the calculation of the margin available for imports of sugar. Firstly, the growth of factory production; secondly, the extent to which this displaces other forms of indigenous production; and thirdly, the growth of consumption. The Finance Member predicted that the result of the operation of all the factors would be the reduction of sugar imports to a very small extent. "On the whole," said the Finance Member, "the best we can do is to assume a figure of Rs. 2 crores for next year's yield of the import duty which is higher than last year's original estimate but considerably lower than this year's results are likely to be." The yield of the excise has been estimated at Rs. 1,96 lakhs, allowing for an increase of roughly 15 per cent. over the revised estimate of the current year's out-turn.

Taxes on Income.—On account of the continued improvements in economic conditions, the Finance Member anticipated a surplus of Rs. 17,60 lakhs under this head for next year, or an increase of Rs. 80 lakhs even over the revised estimate for the current year, or Rs. 1,20 lakhs over the current year's original estimate, after allowing for the reduction in the surcharges.

Currency Receipts.—The estimate of Rs. 81 lakhs under this head assumes Rs. 65 lakhs as the share of the profit accruing to the Government from the Reserve Bank on a full year's working.

EXPENDITURE

The total figure for expenditure exclusive of Railways came to Rs. 85,30 lakhs, which means an increase of Rs. 1,20 lakhs over the current year's revised estimate. Under the head of Interest, there was a total figure of Rs. 9,20 lakhs as against Rs. 10,63 lakhs in the revised estimate for 1935-36. This means a reduction of nearly Rs. 1½ crores. On the whole the improvement in this case came to about Rs. 2 crores.

There was an increase under the head Miscellaneous Adjustments, due to the provision of Rs. 1,58 lakhs for subventions to Sind and Orissa—Rs. 1,08 lakhs for the former and Rs. 50 lakhs for the latter. There was an increase under the head Civil Administration due to the following :—

Rs. 18 lakhs for two health schemes for Delhi ;

Rs. 4 lakhs for Delhi Broadcasting Station ;

Rs. 5 lakhs for Civil Aviation ; and

Rs. 27 lakhs for other items ; thus making up a total of Rs. 65 lakhs.

The proposed estimate of expenditure on Defence came to Rs. 44,85 lakhs, which, according to the Finance Member, showed a real increase of Rs. 21 lakhs. But, in reality the Defence Budget revised figure for 1935-36 stood at Rs. 45,45 lakhs and from this the Finance Member deducted Rs. 60 lakhs being special provision for the construction of Quetta and Rs. 18 lakhs being the sum for new measures. Thus, according to him, the Revised Budget for the current year was Rs. 44,98 lakhs which included Rs. 34 lakhs for Indian Military Service Family Pensions and thus the amount came to Rs. 44,64 lakhs. This last item had been excluded from the Budget Estimates of 1936-37 also. If this amount was not excluded and if the deficit in the Railway Budget caused by strategic lines amounting to about Rs. 2 crores, was taken into consideration, the Military Budget would stand at about Rs. 47 crores and not at Rs. 44,85 lakhs, as estimated by the Finance Member.

WAYS AND MEANS

In accordance with Section 47 of the Reserve Bank Act, the Government received Rs. 43 lakhs as its share of the profits, and this sum was included in the revised estimates for the current year 1935-36.

REMITTANCE

The ways and means estimates for the current year provided £26 millions as the sterling requirements of the Secretary of State. The revised forecast stood at £12 millions. This reduction was due to the large opening balance which the Secretary of State had on April 1, 1935. Up to the end of January 1935, the Bank purchased about £29 millions of sterling in ten months of which about £19½ millions was shown among the assets of the Banking Department. In the Issue Department, there were considerable sterling assets in excess of the statutory requirement and the external position of the Bank was thus very strong. In the subsequent year, the Finance Member expected to call upon the Bank for £41 millions, including the repayment of £16·8 millions of 5½ per cent. Stock, 1936-37, without fresh borrowing in London.

POSTAL CASH CERTIFICATES AND SAVINGS BANK DEPOSITS

The 6½ per cent. Treasury Bonds, 1935, and the 5 per cent. Bonds, 1935, matured in September, and the smaller holders deposited the funds thus received by them in the Postal Savings Bank Accounts. This was responsible for the increase in the revised estimate to Rs. 9,50 lakhs as against the Budget figure of Rs. 8,25 lakhs. The following year's forecast assumed these deposits to be Rs. 8,25 lakhs net, which means the excess of deposits over withdrawals.

LOANS TO PROVINCES

The estimates for provincial requirements for 1936-37 are Rs. 5½ crores in place of about Rs. 11 crores for 1935-36, according to the revised figures.

BORROWING PROGRAMME

The Government took considerable advantage of the low market rates for borrowing, which prevailed both in India and in England during the year. Two loans were issued; the first in July for £10 millions of 3 per cent. Stock, 1949-52, in part replacement of £12 millions of 6 per cent. Sterling Bonds, 1935-37. The loan was issued at 98. The second loan was issued at the end of July. It was a 3 per cent. rupee loan, 1951-54, for Rs. 15 crores at Rs. 96-8, issued through the Reserve Bank. Applications for conversion of 5 per cent. Bonds, 1935, and 6½ per cent. Treasury Bonds, 1935, were

accepted in full and were allotted nearly Rs. 13 crores. £3½ millions of the East Indian Railway 4½ per cent. Debenture Stock, 1935-55, were also repaid during the year.

Next year there are no rupee maturities, but 16·8 millions of 5½ per cent. Sterling Stock, 1936-38, fall due for repayment and this amount is expected to be repaid without further borrowing in London. "This together with the full effect of the conversion operations of the present year enables us to reduce the estimate for interest charges to Rs. 9,20 lakhs, or nearly Rs. 1½ crores less than the revised estimate for the current year."

TREASURY BILLS

The Treasury Bills outstanding on 1st April 1935, amounted to Rs. 18,27 lakhs with the public and Rs. 36,07 lakhs with the Reserve Bank, making a total of Rs. 54,34 lakhs. The Revised Estimate provided for the reduction of the amount to Rs. 13,99 lakhs with the public and Rs. 20,10 lakhs with the Reserve Bank, Rs. 34,09 lakhs in all by the end of March 1936, as against a total of Rs. 46 crores anticipated in the Budget. The outstanding balance of Treasury Bills on 31st March 1937 was expected to be Rs. 20,10 lakhs with the Reserve Bank and Rs. 24,99 lakhs with the public, making a total of Rs. 45,09 lakhs.

The surpluses of the two earlier years and of 1936-37 came to Rs. 9,42 lakhs. In 1936-37 the improvement under interest heads was over Rs. 2 crores which accounted for the surplus in the year. These surpluses would be utilized for beneficial objects, for assisting the newly created provinces and for the reduction of the surcharge; while the small concession in the postal charges should be appreciated.

The Assembly had passed two important amendments to the Finance Bill. Firstly, the amendment for abolishing the salt duty was carried; and secondly, that relating to the reduction of the price of the post card to 2 pice was also passed. The Government, however, got the Bill certified and the Finance Bill restoring these charges was recommended to the Assembly for consideration by the Viceroy. It was rejected there; but the Finance Bill in the original form became law with the help of the extraordinary powers of the Viceroy.

CHAPTER XVII

Financial Implications of Separation of Burma

THE Joint Select Committee of Parliament on Indian Constitutional Reform recommended the separation of Burma from the Indian Federation, which necessitated an equitable apportionment of assets and liabilities between the two new countries. The Select Committee assumed "that it will be necessary to appoint some impartial Tribunal which will in the first place lay down the principles of the apportionment, leaving the application of those principles to be worked out in detail at a later date. It will be necessary to include in the Constitution Act provisions giving the force of law in both countries to the award or awards issued from time to time by the Tribunal." It was further pointed out that steps should be taken for its appointment at as early a date as was reasonably practicable.

In response to this recommendation of the Committee, His Majesty's Secretary of State for India appointed the Amery Tribunal to investigate into the question. The Tribunal was requested—

"(1) to advise as to the basis on which a just financial settlement between the Government of India and the Government of Burma when separated should be made ;

"(2) to indicate—

(i) how their findings under the first 'Term of Reference should be applied.....for allocating to the Government of one country or the other the possession and control of certain property and for imposing certain legal liabilities on the revenues of one country or the other ; and

(ii) so far as practicable the financial consequences of such application ; and

"(3) to advise, in the light of the findings under the First and Second Terms, as to the lines on, and the method by which a complete financial settlement may be achieved between the Government of India and Burma in respect of assets and liabilities existing at the date of separation."

The question was previously examined by the Indian Statutory Commission and an investigation, thereof, was also made after the first Round Table Conference, the results of which are embodied in the *Howard-Nixon Report*. The joint investigators were not able to agree as to the basis of adjustment to be adopted in respect of certain charges. Much valuable information on the subject is also contained in the *Report of the Standing Finance Committee of the Indian*

Legislature, laid before the Assembly in March 1932, and the debates thereon and also in the *Report of the Financial Committee of the Burma Legislative Council and the Memorandum of the Government of Burma*.

The Government of India, in paragraph 93 of their Despatch, dated 20th September 1930, to the Secretary of State for India, suggested that the problem should be solved by drawing up through mutual co-operation between the two Governments an agreed statement of the case for reference to an "Impartial Tribunal". The Sub-Committee of the first Round Table Conference on Burma recommended in their Report dated, 19th December 1930, to the first Round Table Conference a proposal that the case about the adjustment after being explored by the experts of the two Governments should, in the first place, be placed before the Standing Finance Committees of the Indian Legislative Assembly and the Burma Legislative Council and that the representatives of the two countries should be associated with the work of the Tribunal. The first Round Table Conference adopted this recommendation on the 16th January 1931, and it was further confirmed by the Round Table Conference at its eighth Plenary Meeting on the 19th January 1931. On the same day in his speech, the Prime Minister gave an undertaking regarding Burma to the effect that "the Government will pursue the decisions of the Sub-Committee". The Joint Parliamentary Committee, also as noted above, suggested the appointment of an "Impartial Tribunal" to investigate into the question.

The Secretary of State announced the personnel of the Amery Tribunal in February 1935 and the Indian Legislative Assembly recorded its protest by adopting a motion for adjournment on 26th March 1935 against the action of the Secretary of State for India in not adhering to the arrangement arrived at on this issue at the first Round Table Conference. The Government of India should indeed have pressed before the Secretary of State for the acceptance of their recommendations.

The fact, that the representatives of India and Burma were not associated with the Tribunal, has been very much resented by the Indian public; and on September 26, 1935, in its Simla Session, the Indian Legislative Assembly carried a resolution on the Indo-Burma Tribunal Report for the investigation of the question by a fresh impartial Tribunal. It would have, therefore, been in the fitness of things if the representatives of India and Burma were associated with the Tribunal; for then much of the bitterness and ill-feeling would have been avoided.

In addition to this handicap, the terms of reference of the Tribunal were too narrow inasmuch as they were to investigate

the apportionment of the burden between India and Burma only and were thus precluded from considering whether any portion of the burden could properly be assigned to the United Kingdom.

THE BASIS OF SETTLEMENT

Under the first head of their terms of reference, the Tribunal were asked to advise as to the basis on which a financial settlement could be made between India and Burma on an equitable basis. The Government of Burma have advocated that the existing relation between India and Burma is that of an administrative partnership between two distinct Governments. Thus according to this view, the separated portions should, after division, meet the outgoings appropriate to the functions performed in their respective territories. The method advocated by the Government of India is that they would assign to each Government a share of liabilities corresponding to the central assets of which it gets possession. The balance of liabilities remaining would be divided in a proportion based on the combined revenues, central and provincial, collected in their individual territories during a given period prior to separation.

Regarding the basis of settlement, the considered views of the Tribunal are that the existing Government of United India is not a partnership between two existing entities. It is a single Government which will cease to exist after separation and thus leave certain assets and liabilities behind for distribution. "It is our task to advise as to the method by which these assets and liabilities should be valued at the date of separation and in what proportion the two new states which will be created by the act of separation should bear the burden of the excess of liabilities over assets." In assessing these proportions, the Tribunal did not consider the historical aspect of the question and did not enquire whether the terms of the past association had been mutually satisfactory.

The method recommended by the Tribunal (*vide* paragraph 11 of their *Report*) "is that the whole of the assets and liabilities of the present Central Government of India should be valued on lines which we indicate hereafter; that the ascertained value of the assets should be deducted from that of the liabilities; and that responsibility for the balance of liabilities should be assigned to the new countries in a proportion or ratio to be determined by a general consideration of their relative financial and economic situation. The balance to be so divided should include the liability for pensions, whether in course of payment at the date of separation or coming into payment thereafter as a result of central service before separation. We hold pensionary payments to represent, not an

item of the cost of current governmental activity, but the discharge of a liability incurred in the course of past activities, and therefore correctly allocable in the same manner and in the same proportions as a debt outstanding at the date of separation."

The main criticism to the basis of settlement, as determined by them, is that they have taken no account of the fact whether the past association has been mutually advantageous to the two countries. The question should have been approached from a historical point of view, for that would have brought the economic aspect of the separation problem to the forefront and would have set the separationists to ponder over their attitude for separation. Burma should be held responsible for the debt caused by the cost of the Burmese wars. In the early years, she was a deficit province and for many years her railways were operated at a loss. A consideration of factors like these would have made a great difference with reference to the respective shares of liabilities of the two countries and also in regard to other economic matters of importance.

VALUATION OF ASSETS AND LIABILITIES

The terms of reference of the Tribunal required them to consider the various categories of assets and liabilities to be brought into the account. According to the new Government of India Act, existing physical assets such as railways and public buildings will be vested in the Government of the geographical area within which they are located, and the responsibility for the liabilities of the Central Government will likewise be allocated between the two countries. The great bulk of this responsibility will fall on continental India.

The bulk of the liabilities consists of interest-bearing obligations and they are given below in detail :—

Permanent Debt.—This refers to debt so described in the Finance and Revenue Accounts of the Government of India leaving out the liability assumed in respect of British War loan. It means all rupee or sterling loans, held by the public, with or without fixed dates of redemption, and all Railway Annuities, but not Treasury Bills.

According to the Howard-Nixon Memorandum the Permanent Debt was proposed to be assessed as a liability at the nominal amount of the various items ; but according to the Tribunal "the nominal amount of the debt is,, an inaccurate measure of its true burden." They point out that the public debt must include on the date of separation loans differing widely in regard to rates of interest and dates of redemption. These loans range from irredeemable stock bearing a rate of interest of $2\frac{1}{2}$ per cent. to redeemable loans

bearing interest at $4\frac{1}{2}$, 5 or $5\frac{1}{2}$ per cent. The actual burdens, therefore, represented by these loans may differ widely from their nominal amounts. The burden of a loan includes the sum payable on redemption and also the payments made periodically on account of interest. The Tribunal point out that in the case of an irredeemable loan, the latter factor alone is of significance.

In paragraph 18 of their *Report*, the Tribunal hold that the liability attaching to all loans should be assessed with reference to the amounts payable in the form of principal, interest or instalments of annuity, up to the date of repayment. The Tribunal, therefore, recommend that these sums should be reduced at a uniform discount rate to equivalent values at the dates of separation and that the total of these values should be taken to be the liability at that date.

This method necessitates the assumption of the date of redemption of the loan and of the rate of interest at which future payments are to be discounted. The determination of the date of redemption is easy enough according to the Tribunal. Where optional dates are available, it may be assumed that the redemption will take place at the earliest if the loan stands above par and at the latest if it stands below par. With regard to the rate of interest, the Tribunal point out that it should represent the average yield, over a period of two years preceding the date of separation, of the rupee and sterling securities of the Government of India with an unexpired currency, reckoned up to the probable date of redemption of 15 years or more. This could be reduced from the recorded prices on a fixed date in each month, and the result rounded to the nearest quarter of one per cent. This rate could also be employed in calculating the interest to be paid by Burma on her obligation to the Government of India.

This use of an estimated rate introduces an arbitrary element into the assessment of Burma's liability; but the Tribunal point out that a variation of the rate would operate on the annual charge against Burma in two compensatory directions. An increase of the rate would diminish the present value of the total liability and consequently of the net liability payable by Burma. The net effect, therefore, would be that she would become liable for a higher rate of interest on a smaller debt and for a lower rate of interest on a larger debt.

British War Loan.—This debt differs from the Permanent Debt inasmuch as instalments of interest have, for the present, been discontinued in accordance with general arrangements and the sums payable in future are thus uncertain. The Tribunal recommended that Burma should be directly responsible to the British Government for her appropriate share of this form of debt.

Treasury Bills are recommended to be valued at issued price *plus* accrued discount to the date of separation.

Cash Certificates are recommended to be valued at issue price *plus* bonus accrued at the date of separation.

In the case of the following liabilities their nominal amounts are recommended to be accepted as their value on the assumption that the date of separation will coincide with the date to which interest is paid or added to the principal. These liabilities include the following :—

Post Office Savings Bank Deposits.

Balances of Family Pension Funds.

Balances of Provident Funds.

Special Loans and Treasury Notes.

Provincial Balances on which Interest is payable.

Sinking Funds for Loans granted to local bodies.

Miscellaneous Liabilities.—Their list was not examined by the Tribunal, and according to them a final pronouncement regarding the correctness of these items could be made after the date of separation.

Regarding the Military Reserve and the Road Development Fund, the balances under these heads are recommended to be omitted by the Tribunal.

Pensions.—The liability of Burma extends not only to pensions actually in course of payment at the date of separation, but to pensions commencing after that date and earned in part by central services prior to separation. This obligation would be accurately discharged by the periodic refund to India of a due share of the actual pensionary payments. But this method would be very cumbrous in practice. The Tribunal, therefore, recommend “that the liability of Burma should be ascertained as a present value at the date of separation and added to the debt due to the Government of India.”

ASSETS

Coming to the assets side, the Tribunal considered them under various heads. There are commercial assets including the railways. These are assets with a direct earning capacity, the capital cost of which, though met wholly or partly from revenue, has been shown as an off-set to an equal portion of the public debt.

The Tribunal considered three methods of valuation with reference to commercial assets. The method of valuation on a commercial basis with reference to earning capacity was rejected as being impracticable and irrelevant. The method of valuation, on a replacement basis, was also excluded from consideration owing to practical difficulties ; while the method of valuation, on a cost basis, subject to suitable allowance for depreciation was recommended. The net value assigned

to railways as on 31st March 1933 is Rs. 768.62 crores. On the same basis, the valuation attached to other commercial assets, namely, Posts and Telegraphs, Irrigation, Security Printing Press, Currency Note Press, Northern India Salt Department, Forests and Vizagapatam Port, is calculated by the Tribunal at Rs. 1845.14 crores at $3\frac{1}{4}$ per cent. rate of interest.

Similarly, the valuation of other assets is given as below *vide* the appendix on page 25 of the *Report of the Tribunal* :—

				Lakhs of Rs.
New Delhi	..	..	..	14,49.29
Military Lands at Bombay	..	..	..	2,31.12
Dead Assets	..	..	..	91,50.00
Advances to Provinces	..	..	..	1,73,03.74
Other Interest-bearing Advances	..	..	..	20,92.48
Investments of Cash Balances	..	..	..	1,88.24
Investments of Sinking Funds	..	..	..	3,22.49
Cash and Miscellaneous Assets	..	..	..	31,82.90
			TOTAL	3,39,20.26
<i>Add</i> : Railways	..	..	..	7,68,61.86
Other Commercial Assets	..	..	..	18,45.14
			TOTAL ASSETS	11,26,27.26

Having indicated the methods for calculation of the value of assets and liabilities, the Tribunal determine the ratio in which the balance of liabilities should be divided between India and Burma and then they proceed to calculate the annual annuity required to redeem the principal and interest in 45 years.

The total value of liabilities, exclusive of liabilities for pensions in issue, has been calculated by the Tribunal at 14,00,77.36 lakhs of rupees. The total assets in value come to 11,26,27.26 lakhs of rupees and the excess of liabilities over assets thus comes to Rs. 2,74,50.10 lakhs. The share of excess assignable to Burma at 7.5 per cent. is calculated at 20,58.76 lakhs of rupees.

The total assets of which Burma will assume possession have been calculated at Rs. 48,50.93 lakhs, and the liabilities for which she will assume direct responsibility come to Rs. 12,95.64 lakhs. Thus the value of net assets to be assumed by Burma comes to Rs. 35,55.29 lakhs. By adding the share of excess liabilities amounting to Rs. 20,58.76 lakhs, the total is Rs. 56,14.05 lakhs. Allowing for annual interest on this sum at $3\frac{1}{4}$ per cent. or Rs. 1,82.46 lakhs, the annuity required to redeem the principal and interest in 45 years is calculated at 2,38.32 lakhs of rupees. This annuity at $3\frac{1}{2}$ per cent. and $3\frac{3}{4}$ per cent. rate of interest is calculated at Rs. 2,35.46 lakhs and Rs. 2,33.12 lakhs respectively. The Tribunal, therefore, come to the conclusion that these annual annuities at the

three different rates of interest assumed by them would liquidate the debt of Burma to India in 45 years.

The ratio in which Burma is to share the excess of liabilities over assets, has been calculated at 7.5 per cent. by the Tribunal. In paragraph 53 of their *Report*, the Tribunal point out that it is not possible to formulate any theoretical principle, by means of which the relative contributions to be levied can be precisely determined. In paragraph 54 of their *Report*, they indicate the method of calculating the relative proportion in which the relative contribution is to be borne by Burma and India. The actual existing contributions for common purposes have been accepted as the natural starting point. In other words, the respective proportions are to be represented by the respective contributions of India and Burma to the central revenues of the existing undivided Government. Thus, only the central revenues have been taken into account for calculating the ratio. The method of taking central as well as provincial revenues which was advocated by the Government of India has been rejected by the Tribunal. They point out "that in practice our main guide must be the actual administrative and financial organisation of the Indian Empire which is one under which central obligations are met from central revenues alone and provincial revenues are assigned to meet provincial needs. We do not, moreover, consider that we could take cognisance of provincial revenues for this purpose without bringing into the account provincial assets and liabilities.

The grounds advanced in favour of taking the total of provincial and central revenues are, firstly, that the existing division of functions between the centre and the provinces is domestic which is subject to amendment or revocation; secondly, that the existing obligations are ultimately secured on all the revenues, provincial and central; and thirdly, that the combined revenues offer a more equitable basis for determining the relative capacity to pay than is afforded by central revenues alone.

The authors of the Howard-Nixon Memorandum had excluded, from their survey of revenues, the figures relating to Income-tax and considered only the receipts arising from Customs, Salt, Opium, Tributes and Railways. The Tribunal have not excluded the important item of Income-tax; but have rightly excluded Opium, whose receipts are no longer a relevant factor. The receipts, from Railways, have been excluded both on account of their uncertainty and also because they do not represent contributions by the inhabitants of the respective areas in their capacity as tax-payers. Their computations of the direct revenue contributions are thus based on receipts from Customs, Salt, Tributes and Income-tax after being readjusted.

In the case of customs duties, the Tribunal point out that, owing to the geographical position of Burma and her remoteness from the main centres of Indian industry, "the protective effect of the Indian tariff has been very much less marked in Burma than in Continental India, and it has, in fact, operated mainly as a high revenue tariff. In other words, the visible revenue element in Burma's contribution to the maintenance of Indian fiscal policy has been disproportionately high." Hence, according to the Tribunal, "it would not be fair to Burma to take the customs revenue actually collected in Burma into our calculation without some adjustment to correct the peculiar effects of her geographical situation."

On this basis according to the Tribunal, Burma's real contribution for the years 1928-29 to 1931-32 would be about 8 per cent. of the total central revenues of the Indian Empire. In paragraph 64 of their *Report*, they have held "that, for our particular purpose of arriving at a just financial settlement, the proper ratio in which Burma should contribute in respect of the liabilities outstanding at the date of separation should be 7.5 per cent.

It may be pointed out that the ratio worked out by Sir Walter Layton was 10 per cent., while the estimate of the authors of the Howard-Nixon Memorandum was slightly higher. For the reasons mentioned above, the total of central and provincial revenues would have been a better basis than the central revenues alone. Tributes should have been left out of account; firstly, because of their non-economic nature; and secondly, because the revenue from the Indian States is likely to be reduced by a sacrifice of Customs revenue on the part of British India; while Spirit and Kerosene Excise should have been taken into consideration. The receipts, from railways too, should have been included into the account. No special adjustment is necessary on the grounds advanced by the Tribunal to adjust Income-tax or any other form of revenue to suit the geographical incidence. Such adjustment cannot be made with precision and hence it cannot be of much value.

Even accepting the basis of the Tribunal, the quinquennial average of 1929-30 to 1933-34 would be as below:—

(000 omitted.)

		India including Burma Rs.	Burma Rs.
Customs (Gross)	..	38,33,57	3,17,92
Income-tax (Net)	..	17,20,05	1,87,81
Motor Spirit Excise	..	2,72,31	2,02,94
Kerosene Excise	..	2,10,69	1,79,44
Salt (1925-26 to 1929-30)	..	5,56,12	32,51
TOTAL	..	65,92,74	9,20,62

The ratio would then work out at 14 per cent., and making some allowance for miscellaneous considerations, it would not fall below 12·5 per cent.

The ratio of contribution could also be based upon relative national wealth or income. The standard of living and income are higher in Burma than in India. Moreover, the greater mineral and forest wealth of Burma and the existence there of a higher proportion of non-indigenous interests liable to taxation would suggest a higher revenue-producing capacity.

Some comments may now be made with regard to the principles of assessment of the value of assets and liabilities. The limit of apportionable liability has been arrived at by deducting the total value of the assets from that of the liabilities. It may be said that this limit cannot be calculated with fairness to India by a deduction of the value of all her assets, commercial or other, from the total of liabilities.

Before considering individual items of assets and liabilities, a comparison may be made of the amount of apportionable liability as calculated by the Tribunal with that of other official estimates which preceded the Tribunal. Against the estimate of Rs. 274·50 crores of the apportionable liability according to the Tribunal, the estimate of Sir Walter Layton came to about Rs. 300 crores in 1930 ; while the estimate of the Burma Government was 240 crores of rupees (*vide* Government of India Finance Department Memorandum in Appendix IX of the *Despatch of the Government of India to the Secretary of State*, dated 30th September 1930, on the Report of the Indian Statutory Commission). The estimate of the authors of the Howard-Nixon Memorandum was Rs. 226 crores. It may be said that the estimate of the Tribunal includes Rs. 87 crores of part-earned pensionary liability ; while none of the other estimates includes the pensionary liability. To bring them to the same parity Rs. 87 crores may be deducted from Rs. 274·50 crores, which would bring the estimate of the Tribunal to Rs. 186·50 crores. This is the lowest of all the estimates.

The item Miscellaneous Liabilities might be excluded from the list of liabilities on page 24 of the *Report of the Tribunal* ; while some items as Deposit of Local Funds, Balance of the Sinking Fund on Central Loan Account not covered by the credit balance of the Sinking Fund on Central Loan Investment Account should be included in the list of apportionable liabilities. The position of Local Funds is identical with Provincial Balances, and the one item having been admitted for calculating the apportionable liability, the other one should also be treated on the same parity. The case of Sinking Funds not transferred to the Investment Account for inclusion is

strengthened by the inclusion of Sinking Fund Deposits, presumably received in respect of loans granted to local bodies.

On the liabilities side, the Tribunal have included part-earned Pensions amounting to Rs. 87 crores for calculating the apportionable liability; while the fully-earned pensionary liability of the Government of India on 31st March 1933 has not been included. In paragraph 29 of their *Report*, the Tribunal write that "Burma's liability extends not only to pensions actually in course of payment at the date of separation, but to pensions commencing after that date and earned in part by central service prior to separation." The Tribunal have not attempted a calculation of this liability; while in respect of part-earned pensions also the Tribunal in foot-notes on page 27 of their *Report* mention that on account of lack of material for the accurate assessment of this liability, the rough estimate of Mr. Nixon has been adopted for illustrative purposes.

The Tribunal did not calculate the fully-earned pensionary liability on the ground that it could not be done with precision in advance of the date of separation. A large part of the statistical appendix of their *Report* being of an illustrative character, an attempt should have been made to capitalise the pensionary charge of 1932-33 also.

In paragraph 83 of their *Report*, the Tribunal have recommended a scheme of a decreasing annuity payment in respect of pensionary liability. They write, "We have recommended that the liability in respect of pensions should, if possible, be capitalised. There will, however, be a charge coming into course of payment after separation for pensions of staff transferred to Burma, the growth of which would in the normal course be an offset to the decrease in the charge for pensions previously in issue. There are practical advantages in preserving this compensatory action, which has the effect of keeping the total charge for pensions approximately constant. This may, to some extent, be achieved if the liability to India is discharged by an annual payment, decreasing by level decrements over a period of, say, 20 years, and we advise that this course should be followed." This recommendation applies to the liability for pensions in course of payment at the date of separation. The liability for part-earned pensions, which will begin to be discharged by payment after separation, has been recommended to be added to the general debt and to be included in the annuity. It may be pointed out that this latter course should also be adopted in the case of fully-earned pensions, which should also be capitalised.

Attention may now be drawn to the case of the assets that have been deducted from liabilities. The principle should be that only those assets should be deducted which can

meet the interest charge on their capital outlay. All of the assets are not realizable; while their corresponding liabilities are redeemable at some date, and till that date they will continue to be a dead-weight charge on the revenues of the country. Hence, the liability on account of Security Printing Press, Currency Note Press, Vizagapatam Port, New Delhi, Bombay Military Lands and Dead Assets is a dead-weight charge on Indian revenues and these assets should not be deducted from the liabilities to arrive at the apportionable liability.

Regarding the "Dead Assets" the Tribunal have recommended in paragraph 48 of their *Report* that an attempt should be made "to make such estimate of their value, on the basis of cost as is possible from the departmental records of all substantial civil and military properties in India and Burma, subject, however, to the proviso that where the information is not readily available no investigation should be made of the records of a period earlier than the last 50 years". The question is why should not a similar attempt be made to take credit for the "dead" liabilities? Obviously, such an estimate of the value of assets for the past fifty years would very much reduce the apportionable liability and it would be very unfair to India. If this is done, then the question of the past association of the two countries and the contributions made by India to the deficit budgets in Burma in the past should also be fully investigated. But in paragraph 10 of their *Report*, the Tribunal hold that they "do not think it right to enquire whether the terms of the past association have been mutually satisfactory". In view of what they recommend for the estimate of the value of dead assets over the last fifty years, this attitude of the Tribunal towards a calculation of the past liabilities also is not justifiable from the Indian point of view.

Certain other assets also as advances to Provinces, Other Interest-bearing Advances and Cash and Miscellaneous Assets should not be taken into account for the purposes of calculating the apportionable liability. They are in the nature of current business, and each of these assets has a corresponding liability. The advances to Provinces represent liability items and they often exceed the recoveries of the amounts advanced. Hence such assets should not be deducted to arrive at the apportionable liability.

CURRENCY PROVISIONS

Some observations may now be made with regard to the currency portion of the problem of apportionment. According to the Agreement between the Government of India and the present Government of Burma, the latter country after separation also is to continue within the Indian currency system, and certain assets and liabilities arising out of the working of

the currency system are to be apportioned. The main provisions of this Agreement may be stated briefly as below :—

1. The Reserve Bank of India will manage the currency and carry on the banking business of Burma.

2. The Bank will issue notes which will be legal tender in Burma and not in India ; while Indian notes will cease to be legal tender in Burma after some time.

3. The Burma Government will have the right after due notice of issuing distinctive Burman coins. When that right is exercised, Indian coins in Burma will be retired through the Government of Burma. The latter Government will not be entitled to receive in return the equivalent of the nominal value, but must dispose of them in the following ways :—

(a) It may deliver them to the Government of India against their bullion value *plus* the cost of minting an equivalent amount of new coinage ;

(b) It may arrange with the Government of India to recoin them with Burman designs and such recoinage will be free of charge unless the number and composition of the coins are to be materially altered ;

(c) Subject to certain restrictions, the Burma Government may itself dispose of the silver content of rupees which it does not desire to recoin.

4. The Agreement is to be terminable on two years' notice by either side, with a minimum period of three years from the date of separation. When the Agreement terminates, the Burma Government will be free to make its own arrangements for the management of currency and the control of credit. It would thus be free to sever its connection with the Reserve Bank of India. It will be liable for the note issue outstanding in Burma and will receive a corresponding share of the Assets of the Issue Department of the Bank.

5. If the Government of Burma leaves the Indian currency system, she shall have the option of returning currency to the amount of the Treasury balances held in Burma at the date of separation and of cancelling an equivalent amount of her debt to India. This portion of the Agreement is not favoured and endorsed by the Tribunal, who recommend that no exception should be made in this respect to the general arrangement for the redemption of Indian currency. (*Vide* paragraph 79 of their *Report*.)

6. The surplus sterling assets of 19½ crores and the liability of 14½ crores, being 5 crores of security handed to the Reserve Bank and 9½ crores of rupee securities issued to provide the cover, and also the net liability of the Government of India arising out of the past currency or coinage operations shall, according to the Agreement, be excluded from the general scheme of adjustment, and apportioned between the two

countries in a special ratio to be determined from the note issue. After the initial period, the ratio applicable to any year shall be that borne by the average circulation of Burman notes to the total average circulation in Burma and India combined. If Burma decides to sever her connection with the Indian currency system, she would be entitled to a share, calculated on the note ratio applicable at the time, of the surplus assets which would accrue to the Government of India in the event of the liquidation of the Reserve Bank.

The Tribunal have recommended in this connection a modification. They "recommend that all debt outstanding on the date of separation, and all securities or cash held as a result of currency working, but not the store of metallic silver, should be included in the common account" and divided in the proportion in which the general liability is to be divided.

It may be said that the arrangements in respect of the regulation between the monetary systems of India and Burma are not fair to India. Huge losses have been incurred in the past from the revaluation of sterling securities on the changes in the parity of the rupee made from time to time and Burma should bear a share of these losses. No adequate mention of them is made in the Agreement between the two Governments and the Tribunal also did not seek to analyse and investigate them. The Tribunal only mention that there are many "other items less readily distinguishable and perhaps less obviously appropriate for inclusion, and an exhaustive enquiry might result in a list of great length, but of doubtful validity." (Paragraph 73 of their *Report*.) This is hardly a fair position to assume and an investigation of such items is very necessary in fairness to India as well as to Burma. The sale of silver also in the past has resulted in huge losses and their extent should be determined.

The position created by the proposed new Burmese coinage in due course and the obligation to retire Indian rupees imposed on India is an unfair liability. The Burma Government will have the right after due notice of issuing Burman coins and the Indian coins in Burma will be retired through the Government of India. The provision that such retired coins may have to be recoined with Burman designs by the Government of India free of charge will impose an unfair obligation on India. Even if they are to be delivered to the Government of India at their bullion value, the cost of minting an equivalent amount of new coinage shall be defrayed by the Government of India.

Moreover, the possibility that in course of time Burma may sever her connection with the Indian currency system introduces an element of uncertainty into the Indian currency system which may have vast unfavourable repercussions upon

Indian trade and industry. These provisions require a detailed examination, and the Tribunal have not bestowed that attention to them which is commensurate with their great importance.

Certain heads have been treated in a very summary manner by the Tribunal and the decisions of the Tribunal with regard to them require further investigation. These heads are given below :—

(1) The Tribunal have taken into calculation the assets and liabilities only of the Central Government ; but it is to be seen whether all assets and liabilities of all Central and Provincial Governments constituting India and Burma should be taken into consideration or not ;

(2) The liability arising out of the Burmese Wars should be assigned wholly to Burma, instead of only in the ratio of 7·5 per cent. ;

(3) For several years, the deficits to Burman budget were contributed to from the Indian revenues, and the question is whether they should or should not be reckoned amongst the liabilities assignable wholly to Burma ;

(4) Certain liabilities have already been liquidated out of taxation in India and the contribution of Burma towards them was meagre. When the “Dead Assets” are to be calculated for the last fifty years, the question is whether such liabilities should or should not be reckoned for this purpose ;

(5) Whether the valuation of the assets is correct at book value less depreciation and explanation is necessary with regard to the value of forests at Rs. 12·95 lakhs *vide* page 25 of the *Report* of the Tribunal. It cannot be the value of Government of India forests or all forests including Burma forests. Perhaps it refers to the forests of Andamans and Nicobars, and even then the valuation is incorrect ;

(6) The ratio of 7·5 per cent. is not fair to India in view of the greater potentiality for population in Burma, greater forests and mineral wealth, higher standard of living and greater taxable capacity ;

(7) Whether the net assets to be assumed by Burma in the share of Burma's liability and the share of Burma in excess of liabilities over assets, should remain as a debt from Burma to India, or this debt should be assumed by the United Kingdom, which would correspondingly reduce the liability of Indian sterling debt ;

(8) The rate of interest of $3\frac{1}{4}$ per cent. on the debt assumed by Burma to India is rather low in view of the fact that it is the Government of India's own borrowing rate to-day ; while the lending rate to States and Provinces is much higher. In the past, India has paid as high a rate of interest over her debt as 7 per cent. ;

The question was debated in the Simla session of the Indian Legislative Assembly, when a resolution for a fresh impartial Tribunal to investigate into the financial adjustments between India and Burma was carried by the House on September 26, 1935, the Government remaining neutral. In the course of the debate, it was pointed out that the terms of reference of the Indo-Burma Tribunal were too narrow inasmuch as they precluded them from considering whether any liability should be borne by the United Kingdom or not. The Finance Member promised to forward the debate to the Secretary of State for India. The Government should indeed respect the verdict of the Indian Legislative Assembly and appoint a fresh impartial Tribunal, with which the representatives of Indian and Burman non-official opinion should also be associated, to investigate into the question.

The Amery Tribunal recommend the appointment of an Application Committee consisting of three members to apply their principles into practice and to consider, *inter alia*, the following questions :—

“The determination of the rate of interest to be used for the valuation of debt.

The assessment of the capital value to be assigned to divisible pensions, both earned and part-earned.

The appraisement of the value of dead assets both in continental India and in Burma.”

In place of the Application Committee, the appointment of a fresh impartial Tribunal would meet the wishes of the Indian Legislative Assembly, and the Government would be acting in response to the verdict of the House if they get the question investigated again by a fresh impartial Tribunal.

CHAPTER XVIII

Recent Tendencies in Indian Fiscal Policy

THE industrial revolution in England gave her an immense advantage over other countries in the development of large-scale industries. She became an exporter of manufactured goods and an importer of raw materials and food products. It was, therefore, to her advantage to pursue the free trade policy propounded by Adam Smith in his well-known book *The Wealth of Nations*. He was so pessimistic about the adoption of the *laissez faire* policy that he was constrained to remark that it was as difficult to achieve free trade in practice in England as to bring an utopia upon this earth ; but this achievement was made possible in his own life-time.

This policy was suitable for England ; but not for other countries whose economic conditions were far different from those in England. In spite of this, the influence of the writings of Adam Smith made writers like J. B. Say, etc., believe in the universality and immutability of economic doctrines. The hypothetical character of the laws of political economy was forgotten and the universality of economic doctrines as propounded in popular English text-books became the order of the day. It began to be urged that as free trade was good for England, it must necessarily be good for other countries also.

Friederich List was probably the first of the economists who protested emphatically against the dogmas and the so-called universal truths of classical political economy. His classical book *The National System of Political Economy* was a powerful protest against the cosmopolitan principle in the modern economic system, and also against the doctrine of free trade, which was in harmony with that principle. List gave prominence to the national idea, and insisted on the special requirements of each nation according to its circumstances, and specially to the degree of its development. His remark that though it was true that the wind in course of time would carry thistles and there would be forests in place of deserts, and that it was no reason why a good forester should wait for that favourable wind, but he should himself create it, has become classic.

In India also, during the greater part of the 19th century, Government policy was unduly doctrinaire and was sought to be guided by the universal principles of political economy as expounded in English text-books of the day. In the judgment of many thinking people. Government policy in economic

matters did not serve the best interests of the country. The politicians accused the Government of sacrificing Indian national interests for the sake of Imperial or British interests. The late Mr. Justice Ranade led the attack from the economic point of view "with his accustomed erudition and in words unmatched, at least by any other Indian writer, in respect of vigour and brilliance." He drew his inspiration from the writings of List and he set himself the task of proving that economic laws were not universal and immutable and that the fiscal policy in India could not ignore peculiarities of Indian economic conditions, if it was really to be beneficial for the economic development of the country.

The War gave a natural protection to Indian industries. The Indian Munitions Board was established in February 1917, "to control and develop Indian resources, with special reference to the needs created by the War, to limit and co-ordinate demands for articles not manufactured and produced in India and to apply the manufacturing resources of India to war purposes with the special object of reducing demands on shipping". Departments of industries were established in all the provinces as recommended by the Industrial Commission. The War-time stimulus was, however, temporary in character and in course of time, Indian industries were subjected to foreign competition in the absence of any protective duties. Under these circumstances, the long-standing demand for a revision of tariff policy became more insistent than ever before. The Montagu-Chelmsford Report rightly emphasised that Indians should have full liberty of deciding their own tariff policy and that Government had no right to force their free trade convictions on them. The recommendation of the Joint-Select Committee on the Government of India Bill of 1919, in favour of the establishment of fiscal autonomy strengthened the case for protection. The Indian Fiscal Commission was appointed in October 1921 in response to the suggestion of the Committee of the Imperial Legislative Council of 1920 which was to report on the feasibility of Imperial Preference and the future fiscal policy of the Government of India.

The Indian Fiscal Commission recommended discriminate protection and laid down the following principles subject to which protection was to be applied :—

Firstly, the industry must possess some natural advantages, such as an abundant supply of raw materials, cheap power, sufficient labour supply, and a large home market.

Secondly, it must be one which cannot at all develop or develop as rapidly as is desirable without protection.

Thirdly, the industry must be suffering from the effects of foreign competition and under the spur of protection in course

of time, it should be able to face foreign competition without protection and thus be able to stand on its own legs without any artificial prop.

The creation of an expert body known as the Tariff Board was recommended to enquire into the case for protection of different industries on application from them to that effect. The Tariff Board was created in 1924, and since that time, protection has been granted to a number of industries.

Thus it may be said that all these steps implied a departure from the traditional policy of *laissez faire*. They also show that much could be done in India in the sphere of industrial development with the active co-operation and assistance of government. The indifference of the State towards the industrial development of the country has thus been definitely abandoned and efforts are being made to proceed along sound lines. Non-official opinion, however, would favour even greater activity than is being displayed by the Government to bring about more rapid industrialisation of the country. With proper State guidance, the country can go a long way in the matter of industrial development within a measurable distance of time. It is very difficult to agree with the opinion of Mr. Calvert when in his book *Wealth and Welfare of the Punjab* he remarks that "little but failure and disappointment will result from any attempt to compress six hundred years of the industrial history of Europe into a short period of state-subsidized activity."¹ The rapid industrialisation of Germany and Japan in a very short period of time gives the direct and definite lie to such a remark.

The progress of the fiscal policy in India has, however, not been as it should have been. Instead of a policy of "discriminate protection," the steps taken as a whole justify the remark that the Indian fiscal policy is one of discriminate free trade. In place of protection, the policy has definitely become one of imperial preference to which non-official opinion in India has never subscribed as being in the best interests of the country. The Steel Protection Act of 1927 provided for an imposition of differential rates on certain iron and steel articles with a basic duty on articles of British manufacture and an additional duty on those of non-British origin. The opposition in the Assembly did suspect that the Bill contained the principle of preference to British steel to which they were opposed. The protection granted to the iron and steel industry in 1934 definitely provides for preference to British goods and the levying of the excise duty in the case of the industry is in no way conducive to the best interests of the country. Further, the Cotton Industry Protection Act of 1930 embodied

¹ Page 76.

the principle of imperial preference. It raised the general *ad valorem* duty to 15 per cent. and a minimum duty of 3½ annas per lb. was to be levied on plain grey goods. A special protective duty of five per cent. was also imposed, the scope of which was limited to non-British goods. The safeguarding of the interests of the consumer was the stock argument of the Government ; but when the Bill was introduced in the Assembly, the Government took the extraordinary step of announcing in advance, that they would accept only Mr. Chetty's amendment, and no other. The threat of the Government to withdraw the Bill, in case any other amendment, for example Pt. Malaviya's amendment, which proposed a uniform rate on all goods, was passed, led the millowners to vote for the Bill and this did amount to a negation of the Fiscal Autonomy Convention which India is supposed to be enjoying even at present.

It is true that the millowners had asked for protection only against Japan and this they obtained in an adequate measure. But in spite of the declaration of the Government that the preference to British goods was wholly accidental, many people suspect that it was deliberate. The cause of imperial preference cannot be helped by a policy of getting it through the back door. It has been argued that the preference will be interpreted in England as a friendly gesture from India and will have a distinct political value. The counter-reply is that the gesture has not been spontaneous. Its spontaneity would have been definite if the official bloc were neutral and the majority of the elected non-official members had voted for the imperial preference policy that was embodied in the Bill. Further, even if it is granted that the endorsement of imperial preference policy by Indians would win the confidence and good-will of British business interests and would help India in her constitutional advance, then in practice it has not been so.

RECENT TRADE AGREEMENTS

It is very important that the country's economic interests should be regulated by sound policies and long-range vision and controlled by an efficient business organisation. This will be evident by a brief reference to the recent trade agreements entered into on behalf of India with the British Empire countries and with Japan. In order to promote her trade and to offset the effects of contraction in world trade due to the upward movement of tariffs, the United Kingdom has been trying to cultivate closer trade relations with the British Dominions and Dependencies ; and has negotiated an agreement with them for charging preferential tariff rates in future for products exchanged between any two Empire countries. The first move in this direction was made at the Ottawa Conference in 1932 at which the Government of India was also

represented. Among the agreements entered into at that Conference, there was one in respect of India which committed this country to certain reciprocal obligations with Great Britain and with Empire countries for three years, at the end of which period, the agreement was subject to reconsideration.

The official report on the results of the year 1933-34 showed, that in respect of several important commodities included in the Ottawa scheme of preference, the anticipated results to India did not materialise. The share of the British Empire in India's foreign trade has steadily declined in recent years. India's foreign trade with Empire countries fell from 57.1 per cent. during the War to 45.3 per cent. in 1932-33 and with the United Kingdom from 41.2 per cent. to 32.2 per cent. Thus the bulk of India's foreign trade is with non-Empire countries "and India cannot, therefore, be too careful that in accepting comparatively minor advantages from Empire countries she does not antagonise non-Empire countries and jeopardise the prospects of further expansion of her valuable trade with them". The Agreement was terminated in due course, and negotiations are going on for a fresh agreement.

Indo-Lancashire Agreement.—In September 1933, preferential rates were sanctioned separately for a short period for certain classes of Lancashire goods imported into India on the understanding that the Lancashire manufacturers will buy more raw material from India and help her to find markets for her products in the Empire countries. The Indian side undertook not to press for the reimposition of the surcharge on British goods, if the same was removed.²

Indo-Japanese Agreement.—A trade agreement was also entered into between India and Japan which provided for admitting into India 400,000,000 yards of cotton piece-goods on the understanding that Japan would purchase 1,500,000 bales of raw cotton from India. Before the War, Japan's proportion of the total import trade of India was only 2.6 per cent.; while it rose to 15.4 per cent. in 1932-33. Japan has advanced relatively little in her share of the Indian export trade, which was 9.1 per cent. in 1913-14 and 10.3 per cent. in 1932-33. These figures show that the advantages accruing to Japan are far greater than those to India. In the same year, Japan shipped into India nearly 600,000,000 yards of cotton piece-goods. Under the Agreement, her maximum shipments, which will depend upon her consumption of Indian cotton, will be two-thirds of the amount. The balance of 200,000,000 yards is to be divided between Lancashire and the Indian mills over and above their respective contributions in 1932-33.

² See my article in *The Mysore Economic Journal*, 1934, Vol. 20, No. 1.

Indo-British Trade Pact.—This Pact was signed on January 9, 1935, and was to operate during the continuance of the Ottawa Agreement. The Indian Government would give full opportunity to an industry in the United Kingdom to represent her case to the Indian Tariff Board when the case of an Indian industry would be under consideration for protection. Further, the extent of protection shall not be more than will equate the prices of imported goods to fair selling prices for similar goods produced in India, and whenever possible, lower rates of duty would be imposed on the goods of the United Kingdom origin. Even during the currency of protection, the Government of India either on a representation from His Majesty's Government or on their own initiative might make an enquiry into the appropriateness of the existing duties and full opportunity would be given to representations put forward by any interested British industry. The British side would consider the steps to be taken to encourage the use of Indian raw materials in England. This agreement was rejected by the Indian Legislature ; but nonetheless effect was given to it by the Government. In pursuance to it, the Textile Tariff Board presided over by Sir Alexander Murray was appointed to investigate into the case of the cotton textile industry ; and it recommended a reduction in import duties on British goods. These recommendations were immediately given effect to by the Government. Later, the abolition of the Tariff Board was announced by the Government on the ground that there was no new case to be examined by it. The Indian business and commercial opinion was not consulted in the matter ; and naturally, this step has been taken to mean in Indian business circles that the Government has departed from the policy of discriminate protection. That there was no new case for examination by the Board was no argument for its abolition ; because according to the Indian Fiscal Commission, the Board was to examine the working of protection and make recommendations to the Government from time to time for the extension or withdrawal of protection.

These steps taken together go to show a substantial change in Indian fiscal policy, which has become one of imperial preference and even of free trade from that of discriminate protection. This policy deserves a careful examination by some competent *ad hoc* or permanent body on which the representatives of Indian business and commercial interests should have an effective voice.

In some cases, the protection accorded has been neutralised to a great extent by some subsequent action. In the budget for 1934-35 excise duties were proposed to be levied on matches and on white sugar. This was directly against the intention of the recommendations of the Tariff Board which regarded

the recommended protection as necessary and the levying of excise duties does imply inadequate protection.

India by international recognition as expressed through the League of Nations is one of the eight principal industrial countries of the world ; but her industries are at present small in relation to the future extension which they are likely to achieve. This development must be along the lines pursued in Canada. There should be an improvement in agricultural production with the simultaneous enlargement of industrial and commercial activity. In this development, the active assistance and guidance of Government and the official machinery must play a very important part. Under these circumstances, two criteria are of great importance. *Firstly*, the Government should have for its guidance the benefit of the best expert opinion and *secondly*, the interests which may be adversely affected by any proposal must be represented directly or indirectly. A careful plan of economic development must, therefore, be prepared, which should *inter alia* include within its purview the whole fiscal policy of the Government. Trade Pacts like the Ottawa Agreement, etc., can become very useful if they are made part and parcel of a carefully-prepared and well-thought-out economic plan.

It is necessary for this purpose that there must be some machinery to guide the Government. In western countries, such advisory bodies are expert bodies and representative bodies. In India also, some central organisation must be created. There can be a Central Advisory Economic Council, representative of all possible interests supplemented by Provincial Advisory Bodies, to prepare a careful economic plan for the country. Its duty will be to draw up in main outline a general plan of India's economic and industrial development for the next few decades which would provide some guide to the direction of State policy. It would also review periodically the steps taken and the progress made in connection with the realisation of the programme. The whole work would be done in collaboration with the Provincial Economic Advisory Councils. Sub-Committees could also be made a part and parcel of the plan. The machinery could make enquiries and surveys on its own initiative and submit recommendations to the Government from time to time. This would replace the present piecemeal investigations and lead to an orderly development of the economic resources of the country consistent with her best interests. There is a tendency in almost all countries for some sort of economic planning to meet the needs of the situation and India cannot afford to be only an indifferent spectator. There is a vast scope for the increase of the national dividend in the country if the necessary steps are taken in time.

In this respect, it should be emphasised that fiscal policy must play a very important part. Even England, once the home of free trade, has become definitely a protectionist country under the regime of the Nationalist Government. In the U. S. A., wide powers have been conferred upon the President to control dumping and a vigorous protectionist policy is being pursued. The colonies and the British Dominions have, in spite of the ratification of the Ottawa Agreements, pursued their fiscal policy to suit their own interests. India must do the same and must give preference to her own economic interests to those of the Empire countries to improve her industries in an adequate degree. The abolition of the Indian Tariff Board is inconsistent with the policy of discriminate protection pursued during the last decade and goes contrary to the spirit of the recommendations of the Indian Fiscal Commission of 1921.

CHAPTER XIX

Finance and Commerce in the New Constitution

THE Indian Constitution contains important provisions of far-reaching consequences with regard to finance and commerce. Great importance has been attached both in India and in England to this part of the Indian constitutional problem and it has been a subject of great controversy and misunderstanding. The provisions regarding finance and commerce taken as a whole have not found favour either in India or in England in informed business circles.

The Indian delegates to the various sessions of the Round Table Conference and members of different committees appreciated the necessity of reservations and safeguards during the transitional period ; but there has been a good deal of difference of opinion on the nature and extent of these safeguards between the British and the Indian representatives. According to paragraph 2 of the Irwin-Gandhi Pact, these reservations or safeguards were to be 'in the interests of India', but according to paragraph 1 of the Introduction of the White Paper, "these limitations commonly described by the compendious term 'safeguards' have been framed in the common interest of India and the United Kingdom." The statement of Sir Samuel Hoare as Secretary of State for India to the effect that these safeguards "are not stone walls that block the road, but are hedges on each side of the road which no good driver ever touches, but that prevent people on a dark night falling into the ditch nor can they be considered as ultimate controls" has not been agreed to by Indians. The President of the Calcutta session of the National Liberal Federation remarked that "this euphemistic description cannot be accepted and there is a very serious apprehension that they will, as now expressed in the White Paper, be a permanent barrier to the growth of responsibility of the Federal Legislature and the Federal Ministry." The Joint Parliamentary Committee pointed out in connection with commercial and other forms of discrimination that "the importance attached in this country to this part of the Indian Constitutional problem has been much misunderstood in India. . . . The difficulties which would be likely to arise from this uncertainty would, moreover, find a fruitful source of increase in that atmosphere of misunderstanding to which we have alluded. . . . In these circumstances, appropriate provisions in the Constitution Act may serve the double purpose of facilitating the transition from the old to the new conditions, and of reassuring sensitive opinion in both countries."

(Page 204 of the *Report*.) It may be said that neither the recommendations of the Joint Committee nor the provisions of the Constitution Act have been able to allay the suspicions in India.

The problem relating to commercial safeguards is divisible into two issues. One of them is that of discrimination against British imports. Since 1919, the fiscal relations between the United Kingdom and India have been regulated by the Fiscal Autonomy Convention, which was recommended by the Joint Committee on the Bill of 1919. The Convention was to lapse on the passing of the new Act; "and, unless the Constitution Act otherwise provides, the Federal Legislature will enjoy complete fiscal freedom with little in the nature of settled tradition to guide its relationship in fiscal matters with this country."

The Joint Committee pointed out that in making recommendations in this connection, they did not contemplate any measure which would interfere with the position attained by India as an integral part of the British Empire through the Fiscal Convention. According to the Committee, fears were expressed in England that penal tariffs might be imposed in India on British goods with the object, not of fostering Indian trade, but of injuring and excluding British trade. Starting on this assumption, the Committee remarked that "if this be so, it would be clearly of great advantage to allay the fears of which we have spoken by a declaration through and under the Constitution Act of the principles governing the relations between the two countries. The machinery of the Governor-General's special responsibilities, supplemented by his Instrument of Instructions, offers India and the United Kingdom the opportunity of making such a declaration of principles, while at the same time ensuring the necessary flexibility in their interpretation and application."

Thus in the new Constitution the Governor-General will have a special responsibility to prevent penal discrimination against British imports. In other words, "The prevention of measures, legislative or administrative, which would subject British goods, imported into India from the United Kingdom, to discriminatory or penal treatment" would also be a special responsibility of the Governor-General. (Part II, Sec. 12 (F) of the Government of India Act, 1935.) Further, his Instrument of Instructions will also give him full and clear guidance in this respect. It is pointed out in the Report of the Joint Committee that this special responsibility is not intended to affect the competence of the Government and of the Indian legislature to develop their own fiscal and economic policy and that they will be free to negotiate agreements with other powers for the securing of mutual tariff concessions. The Governor-General would intervene in tariff policy or in the negotiation or

variation of tariff agreements only if in his opinion the intention of the policy would be to injure the interests of British trade in India and not to advance the economic interests of India. Further, "the discriminatory or penal treatment" covered by this special responsibility includes both direct discrimination (whether by means of differential rates or by means of differential restrictions on imports) and indirect discrimination by means of differential treatment of various types of products; and that the Governor-General's special responsibility could also be used to prevent the imposition of prohibitory tariffs or restrictions, if he were satisfied that such measures were proposed with the intention already described. In all these respects, the words would cover measures which, though not discriminatory or penal in form, would be so in fact."

DISCRIMINATION AGAINST BRITISH TRADE IN INDIA

The Indian delegates to the various sessions of the Round Table Conference admitted that there should be no discrimination between the rights of the British mercantile community, firms and companies trading in India and the rights of Indian-born subjects. The British Indian Delegation in their Joint Memorandum accepted the principle of "a fair field and no favour". In view of these assurances, the question is why it became necessary to deal with this matter at all in the Constitution Act and the reply of the Joint Select Committee is to the effect that "utterances have been made which could not fail to give rise to suspicions and doubts, and that statutory provision by way of re-assurance is an evident necessity."

In this connection it may be pointed out that in the opinion of the Committee statutory provision by way of re-assurance was necessary in spite of the assurances in this behalf of the Indian delegates including the delegation of Indian commerce; but nowhere have the Committee thought it necessary to recommend the incorporation of provisions in the Constitution Act by way of re-assurance to allay the unanimous suspicions of Indian representatives.

Discrimination may be either administrative or legislative. There would be a special responsibility of the Governor-General and Governors in their respective spheres for the prevention of discrimination. If the Ministers make proposals which would be discriminatory in effect, the Governor-General or Governors as the case may be would decline to accept their advice or would exercise the special powers flowing from the possession of a special responsibility. The Joint Committee recommended that "it should be made clear in the Constitution Act that this special responsibility extends to the prevention of administrative discrimination in any of the matters in respect of which

provision against legislative discrimination is made under the Act." (Para 348 of the *Report*.)

With regard to legislative discrimination, the Indian Statutory Commission had regarded the technical objections to any attempt to define discriminatory legislation in a constitutional instrument as decisive; but the Act is to contain these provisions. In this connection, the British Indian Delegation in their Memorandum pointed out that a friendly settlement by negotiation was by far the most appropriate and satisfactory method of dealing with this complicated matter. The Joint Committee endorsed this view and further opined that these arrangements could only be extended to include the relations between India and the Dominions by mutual agreement; while they also thought that any statutory enactment would be based upon the principle of reciprocity.

The Indian Government will have statutory powers to exclude or remove undesirable persons, domiciled in the United Kingdom or elsewhere; but no law restricting the right of entry into British India would apply to British subjects domiciled in the United Kingdom; and further, no law relating to taxation, travel and residence, the holding of property, the holding of public office or the carrying on of any trade, business or profession would apply to British subjects domiciled in the United Kingdom, in so far as it imposed conditions or restrictions based upon domicile, residence or duration of residence, race, religion, language or place of birth. (Part V, Chapter III, Sec. 111 of the Government of India Act, 1935.)

With regard to companies incorporated in the United Kingdom, the Joint Committee recommended that "we are of opinion (1) that a company incorporated now or hereafter in the United Kingdom, should, when trading in India, be deemed to have complied with the provisions of any Indian law relating to the place of incorporation of companies trading in India, or to the domicile, residence or duration of residence, language, race, religion, descent or place of birth, of the directors, shareholders, or of the agents and servants of such companies; and (2) that British subjects domiciled in the United Kingdom who are directors, shareholders, servants or agents of a company incorporated now or hereafter in India should be deemed to have complied with any conditions imposed by Indian law upon companies so incorporated, relating to the domicile, residence or duration of residence, language, race, religion, descent or place of birth, of directors, shareholders, agents or servants." (Also see Part V, Sections 113, 114 of the Government of India Act, 1935.)

These statutory enactments are to be based upon reciprocity between India and the United Kingdom. If a law is passed in the United Kingdom putting restrictions upon Indian

subjects or companies domiciled in India in respect of matters from which in India British subjects and companies of the United Kingdom domicile would be exempt, the exemption enjoyed by the latter would *pro tanto* cease to have effect.

This provision is unfair for companies of Indian domicile and for the Indian subjects of His Majesty; because the United Kingdom Government would be at liberty to pass a law imposing restrictions upon individuals and companies domiciled in India, though similar privileges which British companies might be enjoying in India would cease to have effect after that in the future. But a similar right to impose restrictions upon British subjects and upon companies of British domicile in India is prohibited statutorily. Why should not a similar right be granted to the Indian legislature to impose restrictions upon persons and companies of the British domicile trading in India? In that case any privileges which Indian subjects and companies might be enjoying in the United Kingdom might also *pro tanto* cease to have effect. That would be reciprocity in the real sense of the term. There does not seem to be any reason why restrictions, not placed upon the British legislature, should fetter the hands of the Indian legislature.

In connection with the principle of reciprocity the relevant portion of the speech of Sir Purushottamdas Thakurdas on commercial discrimination made at the Federal Structure Sub-Committee Meeting on November 19, 1931. may be usefully quoted. He said, 'But I want to point out that so far as trade with Great Britain is concerned, the effects of reciprocity will be of little or no value to India. What has India to gain from England reciprocating in the way which Mr. Benthall has indicated? It has to be noted that in spite of the relations between Great Britain and India during the last 100 years at least there is no Indian House or firm established here which does commercial business with India on a scale which can be computed in any responsible proportion to what is being done by British Houses..... If after a hundred years the enterprise of Indians in London is at such a low ebb as this, I only wish to point that reciprocity cannot mean much to us for a long time.'

Section 115 of the Government of India Act, 1935 contains provisions in response to the recommendations of the Joint Parliamentary Committee for the case of ships and shipping. Ships registered in the United Kingdom are not to be subjected by law in British India to any discrimination whatsoever, as regards the ship, officers or crew, or her passengers or cargo, to which ships registered in British India would not be subjected in the United Kingdom.

This provision is again very unfair from the point of view of Indian shipping. In simple language it means that even the reservation of Indian coastal trade to Indian ships is to be prohibited.

The Navigation Laws in England which were repealed in 1849 after remaining on the statute books for centuries reserved the coastal trade and the trade between England and the Colonies only to ships owned and manned by Britishers. The U. S. A. and the Dominions also have encouraged their shipping industry by reserving coastal trade for their nationals.

Even the power of retaliation against those Dominions which have anti-Asiatic laws applying to India has been withheld from the Indian legislature. This goes contrary to the spirit of the resolution of the Imperial Conference of 1921 which empowers India to restrict immigration into her territory as it may suit her and to discountenance the disabilities to which her nationals are subjected in parts of the British Commonwealth. The Minority of the Indian Fiscal Commission were of the opinion that "no agreements based even on reciprocity in trade matters should be entered into with any Dominion which has on its statute books any anti-Asiatic legislation applying to the Indian people. . . . To the Indian people their self-respect is of far more importance than any economic advantage which any Dominion may choose to confer by means of preferential treatment. We may confidently state that the people of India would much prefer the withdrawal of such preference as they would not care to be economically indebted to any Dominion which does not treat them as equal members of the British Empire having equal rights of citizenship."¹

It is thus not in the interests of India to deny her the power of retaliation which is her just right and which she possesses according to the resolution of the Imperial Conference of 1921 though it is unimplemented. The Dominions claim that in certain circumstances they have a right to exclude even the people of Great Britain and this right seems to have been exercised once or twice. Further, the Baltic Exchange and the Jute sale rooms in London were not open to Indians till 1929 and even the Bank of England has laid down that no financial accommodation would be granted by the Bank on the security of Bills, unless they bear two English names of which one should be that of the acceptor.

With regard to the grant of bounties and subsidies, the Joint Parliamentary Committee apparently accepted the findings of the External Capital Committee of 1925 ; but the

¹ Minute of Dissent to the *Indian Fiscal Commission Report*, para. 41.

qualification introduced is a negation of this acceptance. The Committee write, "But we think that a distinction may properly be drawn between companies already engaged, at the date of the Act which authorises the grant, in that branch of trade or industry which it is sought to encourage, and companies which engage in it subsequently; and we therefore recommend that in the case of the latter it may be made a condition of eligibility for the grant that the company should be incorporated by or under Indian law, that a proportion of the directors (which should, we think, not exceed one-half of the total number) shall be Indians, and that the company shall give such reasonable facilities for the training of Indians as the Act may prescribe. In the case of the former, the reciprocal provisions which we have suggested would continue to apply, and the company should be equally eligible to participate in the grant with Indian companies."² Section 116 of the Government of India Act, 1935, contains provisions to these effects.

Further, it would be the duty of the Governor-General and of the Governors that in exercising their discretion in the matter of assent to Bills, they would not be bound by the terms of the statutory prohibitions in relation to discrimination. They would have the power to withhold their assent from any measure which, though not in form discriminatory, would in their judgment have a discriminatory effect. The Joint Parliamentary Committee regarded it an essential concomitant of the stage of responsible government that the discretion of the Governor-General and of the Governors in the granting or withholding of assent to all Bills of their legislature should be free and unfettered. They thought that this condition would not be fulfilled if the Governor-General and Governors regarded the exercise of their discretion as restricted by the terms of the statutory prohibitions. The Committee further recommended and their recommendation has been embodied in the Act to the effect that the Instrument of Instructions should contain a provision that if the Governor-General and the Governor are doubtful about a Bill offending against the intentions of the Constitution Act in the matter of discrimination, they should be able to reserve the Bill for the signification of His Majesty's pleasure.

These provisions imply that the Governor-General and the Governors *in their discretion* will be the final arbiters with regard to the Bills being of a discriminatory nature and the Ministers will thus have practically no powers in this connection. Fiscal autonomy would thus cease to exist in any shape or form; because a Bill which proposed higher duties against

² Paragraph 356 of the *Report*.

British goods in the interests of a particular Indian industry might not be allowed to be moved by the Governor-General. He might also refuse a Bill to give bounties to an Indian industry on the ground that it was discriminatory in effect though not in form. Such provisions cut at the very root of fiscal autonomy and they would make the Indian Ministers completely powerless.

FINANCIAL SAFEGUARDS

An analysis of the provisions of financial safeguards shows that the future Federal Government will not have adequate control over finance. At present the Finance Department controls the currency and exchange and also the revenue and expenditure of the Government; while the Commerce Department controls the Indian railways whose gross budget amounts to about 100 crores of rupees.

When we talk of the transfer of financial control with safeguards the natural inference is that the Commerce Department will be transferred to popular control. In this connection paragraph 74 of the White Paper states that His Majesty's Government consider it necessary that, while the Federal Government and Legislature will necessarily exercise a general control over railway policy, the actual control of the administration of the State railways in India including those worked by companies, should be placed by the Constitution Act in the hands of a Statutory Railway Authority, so composed and with such powers as to ensure that it is in a position to perform its functions upon business principles without being subject to political interference.

The Joint Committee recommended that not less than three of the seven members of the Railway Authority should be appointed by the Governor-General *in his discretion* and that it should not be constituted on a communal basis. "The powers which the Governor-General will possess of taking action in virtue of his special responsibilities (including, of course, that relating to any matter which affects the Reserved Departments) must extend to the giving of directions to the Railway Authority."

Questions of coinage and currency will now be entrusted to the Reserve Bank. The White Paper proposals required the prior assent of the Governor-General *in his discretion* to the introduction of legislation affecting the portion of the Reserve Bank Act which regulates the powers and duties of the Bank in relation to the management of currency and exchange. According to the Joint Parliamentary Committee these provisions do not cover the constitution of the Bank itself. According to them so narrow a definition would leave open the possibility of amendment to other portions of the

Act which might prejudice or even destroy some of the features of the system essential to its proper functioning. It was, therefore, recommended "that any amendment of the Reserve Bank Act, or any legislation affecting the constitution and functions of the Bank, or of the coinage and currency of the Federation, should require the prior sanction of the Governor-General *in his discretion*. Certain of the functions vested by the Reserve Bank Act in the Governor-General in Council (of which an important example is the appointment of the Governor, Deputy Governor and four nominated Directors of the Bank) will in future require to be vested in the Governor-General *in his discretion*, and appropriate provision in the Constitution Act will be needed to secure this."³ Sections 153 and 154 of the Government of India Act, 1935, give effect to those recommendations of the Joint Parliamentary Committee.

Virtually it means that the Indian legislature will have no power to amend the Reserve Bank Act, because it will require the prior consent of the Governor-General in his discretion and the appointment of the Governor, Deputy Governor and four Directors would in future vest in the Governor-General *in his discretion* and not in the Governor-General in Council.

CREDIT AND FINANCIAL STABILITY

According to paragraph 31 of the Introduction of the White Paper, "the object of the Governor-General's special responsibility for the safeguarding of the financial stability and credit of the Federation is to confer on him powers to step in, if the need should arise, in the event of the policy of his minister in respect, for example, of budgeting or borrowing being such as to be likely in the Governor-General's opinion to endanger seriously the provision of resources to meet the requirements of his reserved departments or any of the obligations of the Federation whether directly or indirectly by prejudicing India's credit in the money markets of the world." This safeguard nullifies responsibility to a great extent. This has been inserted with a view to safeguard the position of the British investors. The total debt of India up to 31st March 1931, amounted to Rs. 1162·96 crores of which the internal debt was Rs. 645·95 crores and the external debt Rs. 571·01 crores. (Page 374, *India in 1930-31*.) It may thus be said that the total indebtedness of India is half in India and half in Great Britain. With this special feature, it cannot be said that Indians would be so rash as to ask for any system of reforms which would jeopardise the safety of those in India who have lent to the Government to the extent of Rs. 645·95 crores. Most of this debt of India is productive debt. Why

³ Paragraph 391 of the *Report*.

then this extra caution that the management of finance in India cannot be left with the legislature in India and specially cannot be left to be looked after by those whose interests are the same as those of the British investors ?

The City Financiers may be satisfied but the Indian investors cannot be neglected, because if the latter's confidence is lost the credit of the Government cannot be maintained even for a day. It is the Indian investor who, in future, will provide most of the money and the Government should do nothing which may lose them his confidence. The fact that the recent 3 per cent. Government of India loan was over-subscribed in 20 minutes shows that India has adequate monetary resources which can satisfy the financial needs of the Government of India. The interests of the Indian investors should, therefore, be primarily considered.

Argentine and America borrowed money from London. Did they provide any safeguards in their constitution ? If not why should the City Financiers ask for safeguards from us ? We have been with them and shall remain with them as co-partners in the Empire. The Argentine and America are not partners with England and still they got money without providing for special safeguards. The best safeguard is the goodwill of the Indians. If 80 per cent. of the revenue is mortgaged to London through the Governor-General, then the position of the Indian investors is simply jeopardised and is not at all secure and, therefore, Indians must oppose these safeguards.

FINANCIAL ADVISER

No case seems to have been made for a Financial Adviser. This was a new proposal at the Third Round Table Conference to which Indian representatives did not agree. If at all necessary he should be appointed in consultation with the Minister and should in no way be a representative of vested interests either in India or in England. Under the proposals of the White Paper he will be responsible to the Governor-General and will thus be ultimately controlled by the Secretary of State. Under the circumstances, he can easily be a source of danger to the working of the Constitution. Section 15 of the Government of India Act, 1935, provides for the appointment of a financial adviser who shall assist the Governor-General in discharging his special responsibility to safeguard the financial stability and credit of the Federal Government. He shall also give his advice to the Federal Government on such financial matters on which he may be consulted. He shall hold office during the pleasure of the Governor-General, whose powers with regard to the financial adviser's appointment, dismissal, salary, etc., shall be exercised by him *in his*

discretion. Section 15 also contains a proviso to the effect "that, if the Governor-General has determined to appoint a financial adviser, he shall, before making any appointment other than the first appointment, consult his ministers as to the person to be selected."

THE GENERAL BUDGET

Coming to the General Budget amounting to about Rs. 90 crores net, it may be noticed that the finance of the Army is to be controlled by the Crown which takes away nearly 47 crores; while debt charges amount to about Rs. 15 crores and pensions and other charges about Rs. 10 crores which are to be reserved to the Crown. Thus out of a budget of about Rs. 90 crores, about Rs. 72 crores is to be reserved to the Crown. When, therefore, 80 per cent. of our revenue is reserved to the Crown and the legislature will have no say with regard to this amount, and when in the remaining 20 per cent. also the Governor-General will be able to interfere in cases of emergency which will come under his special responsibility, it will be seen that the transfer of control to the future Finance Member of India is not substantial. If we are to have control over our finances, the mortgages should first be reduced and then the safeguards will be tolerable even if they are rigid. As the position stands at present, even if the safeguards are relaxed it is not possible to get any effective control over our finances.

This can be done by reducing the military expenditure and the debt charges substantially. According to the Simon Commission the military expenditure of India increased by 100 per cent. between 1913 and 1928; while in the case of the Dominions the increase was only 33 per cent. and in the case of Great Britain 48 per cent. Prices are now much lower than in 1913 and there is a great scope for reduction in this item.

With regard to debt services, it should be said that Indians are prepared to bear every pie of debt they have borrowed, but expenditure on account of the Egyptian War, the Sudan War, the Abyssinian War, etc., should not have been debited to Indian revenues. If India's obligations were thoroughly examined and if probably the Report of the Capitation Tribunal were to see the light of the day, a very strong case would have been made out for reducing this burden from the shoulders of India. If this could be done even rigid safeguards would be tolerable.

It may thus be said that a careful examination of the provisions of the Government of India Act, 1935, relating to finance and commerce shows that very serious handicaps have been imposed upon the Indian legislature in these respects. Under these circumstances, it would be very difficult either for the Federal Legislature or for the Federal or Provincial Ministers

to pursue a policy to suit the interests of Indian commerce, trade and industries. The policy of the progressive Indian Ministers is likely to come into conflict with the special powers and responsibilities conferred upon the Governor-General and the Governors. Indeed, assurance to British investors and British traders is necessary on the eve of the great constitutional change, shortly coming into operation in India; but the best assurance in this connection is goodwill; while the statutory assurance, if necessary at all, should also contain provisions or safeguards for Indian business trade and commerce.

CHAPTER XX

Railway Finance

THE economic development of a country is dependent upon a well-organised and well-developed system of transport. The industrial revolution of the 19th century was caused and facilitated by the growth of suitable systems of transport. Large-scale production requires cheap and quick means of communication, which are necessary to send goods from the places of their production to places of consumption. In the absence of an adequate and suitable system of transport, the industrial development of the various countries would have suffered considerably or in fact beyond comprehension.

In India the gradual break-up of the isolation of the village is due to railways, which have facilitated the interchange of goods between villages and towns. They have enabled raw materials to go out of India and thus facilitated the commercialisation of agriculture in the country. Without railways, the Punjab Canal Colonies, the Sind Irrigation Scheme and other irrigation schemes would not have been possible. They have promoted and facilitated the internal and foreign trade of India and they have augmented the revenues of the Central and the Provincial Governments. They have also enabled famine relief operations to be organised and co-ordinated. The misery, starvation and the high death roll of the famines in India in the past have been removed, because railways now facilitate the transport of food grains to the areas of droughts and scarcity from those of superabundance. They have been responsible for the extension of markets in India for industrial and agricultural products.

Their evils should not be ignored. They have intensified foreign competition and have been responsible for the decay of the Indian handicraft industries in the past. They have encouraged the advent of foreign capital into the country both as investment capital and as loan capital, and the former has many disadvantages. In the past their rates policy has not been sound and initially they were very costly to the Indian tax-payer. In this chapter, the problems relating to the financing of Indian railways will be considered ; while a brief reference will also be made to other allied problems.

The history of Indian railways closely reflects the financial vicissitudes of the country. The construction of railways in India was contemplated some time after the establishment of railways in England. It is necessary to make a brief review

of the history of Indian railways to understand the policy of Government towards railway construction in this country and to understand the methods by which railway finance has been raised.

The first period of the history of railways in this country may be called the period between 1844 and 1869, characterised by the Old Guarantee System. Three experimental lines were sanctioned in 1845, which were the East Indian Railway from Calcutta to Raniganj about 120 miles in length; the Great Indian Peninsular Railway from Bombay to Kalyan, a distance of about 33 miles, and the Madras Railway from Madras to Arkonam, a piece of about 39 miles. But Indian railway construction on a serious scale dates from Lord Dalhousie's famous Minute of 1853 on Indian Railways. In his Minute he pointed out the advantages to India of the construction of railways. He suggested a great scheme of trunk lines linking the presidencies with each other and the inland regions with the principal ports. He preferred the agency of companies under Government control and supervision, to direct construction by Government; because he thought that the withdrawal from other important duties of the large number of officers required for railway construction would be detrimental to the public interest and because commercial undertakings according to him did not fall within the proper functions of Government, particularly in India, where it was necessary to discourage people depending too much on Government. This would also encourage the flow of British capital into India for trade and manufactures. He suggested that these companies should have a Government guarantee of interest to insure private capital against the risks of pioneering work.

The difficulties of the Mutiny in moving the troops and other provisions powerfully reinforced the need of railway construction in this country, and by the end of 1859 contracts had been entered into with eight companies for the construction of 5,000 miles of line, involving a guaranteed capital of £52 millions. These companies were (1) the East Indian; (2) the Great Indian Peninsular; (3) the Madras; (4) the Bombay, Baroda and Central India; (5) the Eastern Bengal; (6) the Indian Branch, later the Oudh and Rohilkhand State Railway; (7) the Sind, Punjab and Delhi, now merged in the North Western State Railway; and (8) the Great Southern of India, now the South Indian Railway. The main features of the contracts with these guaranteed companies were as follows :—

- I. Free grant of land ;
- II. A guaranteed rate of interest ranging from $4\frac{1}{2}$ to 5 per cent. and payable at 22 *d.* to the rupee ;

- III. Utilization of half the surplus profits earned by the companies to repay Government any sums by which they might have had to make good the guarantee of interest in previous years ;
- IV. Government control and supervision ; and
- V. Option to Government to purchase the lines on fixed terms at the close of 25 years.

The early results of the system were disappointing, because the railways failed to make profits sufficient to meet the guaranteed interest and the deficits in the railway budget amounted to Rs. 1,672 lakhs by 1869. This was attributed by some critics to the unnecessarily high standard of construction adopted and to the extravagance of the companies, who had no incentive for economy of construction under the guarantee system. The Indian Railway Committee presided over by the late Sir William Acworth has, however, expressed the opinion that they "see no reason to doubt that the formation of guaranteed companies with headquarters in London was wise at the time when the policy was adopted. India needed railways. The money to build them could only be found in England. And in the middle of the nineteenth century company shares were the form in which capital would naturally be raised. And no company could be expected to embark its capital without a guarantee from the State."¹ Others have denied that English capital could have been attracted only under the system of guarantee. Mr. William Thornton in his evidence before the Parliamentary Committee of 1872 pointed out that English capital would have come into India for railway construction even without the guarantee of the State ; because there was no scope for remunerative investment at home. It was, therefore, seeking outlets in South America and other countries and it would not have neglected India. In any case, the guaranteed rate of interest could easily have been lower ; because later on at the guaranteed rate of interest of $3\frac{1}{2}$ per cent. the British investors invested money in Indian railways. The terms of contracts were thus probably unnecessarily liberal to the companies and this fact coupled with the lack of development of industries in India to supply materials to railways made the railways very expensive.

From 1869 the formation of guaranteed companies ceased and the new lines built in the next ten years were constructed by the Government and managed by them directly. It was decided to borrow annually amounts up to two million pounds for constructing lines to be managed by the State and the metre gauge was adopted on grounds of economy. The contracts with the original guaranteed companies ran for 50

¹ See Paragraph 188.

or 60 years; but in every case the Government reserved the right to buy out the companies at an intermediate date after 25 or 30 years. These powers first began to be exercisable in 1879 and have continued to be exercised in almost every case since then. The form of the purchase price was paid in cash, in India stock; while in some cases wholly or partly in terminable annuities. The East Indian Contract was terminated in 1879 and the value of the shares of the Company was fixed at £125 per £100. The purchase price was ascertained to be £3,27,50,000; and this sum was commuted into a terminable annuity of £14,73,750, payable annually till February 1953. Thus the East Indian System became Government property. The concession of the Great Indian Peninsula was for 50 years from 1850; but it was not denounced in 1875 and accordingly ran till 1900. This line was also mainly paid for in terminable annuities.

By the early eighties, the current of opinion in favour of direct state management had spent its main force and Government again considered it expedient to enlist the aid of private enterprise in the construction of railway lines required as a protection against famine. Thus under the new system the Southern Mahratta, the Bengal-Nagpur and the Midland Railways came into existence. The features which differentiated these systems from the older guarantee system were as follows:—

(1) the lines constructed by the companies were declared to be the property of the Secretary of State for India, who was empowered to terminate the contracts at the end of twenty-five years after their respective dates of entry or at subsequent intervals of ten years, on repayment of capital at par to the companies;

(2) interest was guaranteed at $3\frac{1}{2}$ per cent.;

(3) Government retained three-fifths of the surplus profits for its own benefit.

Other types of railway companies also came into existence during this period. Native states were invited to undertake construction in their own territories and the Hyderabad State was the first to extend a guarantee of interest to the State railway. Then the system of rebates was introduced. Companies were offered a rebate on the gross earnings of the traffic interchanged with the main line, so that the dividend might come up to 4 per cent.; but the rebate was limited to 20 per cent. of the gross earnings. These rebate terms did not prove attractive in view of the competition of 4 per cent. trustee stocks. Hence they were revised in 1896 to provide for an absolute guarantee of 3 per cent. with a share of surplus profits or rebate up to the full extent of the main line's net earnings in supplement of their own net earnings. The total was limited

to $3\frac{1}{2}$ per cent. on capital outlay. These rebate terms were revised from time to time to provide for an absolute guarantee, with a share of surplus profits or a higher rebate, to meet the requirements of the market. The requirements of the market were met and there was a mild boom in feeder railway construction; and the stock of sound companies stood at a substantial premium.

This method of encouraging the construction of lines thus originated, because the Government of India were unable to furnish the necessary capital. According to the Acworth Committee this method had no other merit except that it enabled lines to be built which otherwise would not have been built. The following disadvantages were pointed out by the Committee :—

1. The Branch Line Company is usually a fifth wheel to the coach. It implies in some cases a separate construction staff; it always implies a separate Board of Directors, and separate accounts.

2. Where the branch is worked by the main line, if its Directors feel that the management is unsatisfactory, they not only make representations to the main line administration, but in the last resort can appeal to the Railway Board which does not make for harmony.

3. Capital raised by a small private undertaking, even with a Government guarantee, will cost more than money raised by the State.

4. There is a great confusion on account of the multiplication of independent Railway Companies. Each company desires to reserve for itself a separate sphere of influence; and jealously demands that, if any new-comer intrudes into that sphere, he shall pay toll to the original concessionaire. This only complicates a situation which should be considered solely from the point of view of the public interest.

5. The existing Branch Line Companies have ceased for some time to raise additional capital for capital requirements. They have either obtained overdrafts from various banks for this purpose at heavy rates of interest or issued debentures at special rates of interest, usually about 7 per cent., or in several cases asked for money to be advanced to them by the Railway Board. So far, therefore, from reducing the amount that the Government of India have to raise in the open market, they are at present increasing that amount.

6. Another serious disadvantage not mentioned by the Acworth Committee is that the main line usually works the Feeder or Branch Line for a remuneration which, in most cases, is limited to a maximum of a fixed percentage of the gross earnings of the Branch Line (usually 40 per cent. or 50 per cent.)—terms of remuneration which are grossly inadequate.

The result is that many of the main lines whose working expenses are from 60 to 80 per cent. of the gross earnings are saddled with heavy expenditure which ought to have been debited to Branch Line Companies. Where the Branch Line Companies are successful, that is, where their shares command a heavy value, their profits are inflated owing to their working expenses being artificially reduced. Again, where in the case of less prosperous Branch Line Companies, the Government has to make a direct subsidy in order to make up the guaranteed interest on the capital, the amount paid by way of subsidy does not reveal the true loss of the Government in connection with the Branch Line Company. To this subsidy should be added also the additional loss incurred from the main line working the Branch Line at less than the actual cost. This is not, however, the full loss sustained by the Government in connection with these companies. They have been supplied with land free of charge and the cost of such land is not taken into account either in the capital or the revenue accounts of the companies concerned.

The arguments used in favour of these companies were :—

1. That money had been raised which the Government of India was unable to furnish.

2. That a claim was made that the Branch Line Company obtained from local sources money that would never be subscribed to a Government loan.

3. That there may be cases of a Branch Line of smaller gauge worked independently, which the Branch Line Company can operate more economically than a main line.

4. That the utilisation of the agency of these companies is advantageous in cases where the Government itself is unable or refuses to raise the necessary amount of capital for new constructions. Such a position is not likely to recur in the future. This method is a far more expensive method of raising money for the construction of railways than direct Government loans can ever be. The total amount of capital raised through their agency has only been about Rs. 10½ crores. In itself this amount is less than the lapse that occurred in the Railway Budget in the provision of capital expenditure for the year 1933-34.

The Acworth Committee, therefore, recommended that the aim of the Government should be to reduce by amalgamation the number of existing companies and that it should only be in cases where the State cannot or will not provide adequate funds that private enterprise in the direction should be encouraged.

In 1925, the Government decided that the Branch Line policy should be abandoned and that an endeavour should be made to reduce the number of the existing Branch Line Companies. If on any occasion the Government of India should be

unable to find funds for construction, and should it be considered advisable to tap fresh sources for subscription to railway loans by offering terms different from those given to the ordinary Government loans, that is, by offering not only a fixed rate of interest, but a share in the profits of a particular Branch Line, there appears to be no advantage of using a half-way house specially to float a loan on such terms: there is no reason why the Government should not raise the loan direct. The Government have also expressed their readiness to construct such lines for purely local or administrative convenience upon guarantee against loss from a Local Government or a local authority concerned. Some such arrangements have been made with Local Governments in Bombay, Burma, Punjab and Madras.

In the next period between 1900 and 1914, there was a rapid extension and development of railways and the railways began to make profits. In 1905, the Railway Branch of the Public Works Department was abolished and the railways were entrusted to a separate department. A Railway Board consisting of a President and two members was established at the head of the railway system under the Department of Commerce and Industry. In 1908, the Mackay Committee on Railway Finance recommended an annual capital expenditure of £12½ millions on railways and it could be periodically revised. The Government could not adhere to the standard recommended by the Mackay Committee; but they spent much larger sums than in previous years. In this period, the railway mileage increased from 24,752 in 1900 to 34,656 miles in 1913-14 and the capital outlay increased from Rs. 329·53 crores to Rs. 495·09 crores.

It was during this period that railways began to make profits. The losses to the State up to 1898 amounted to Rs. 57·80 crores, and for the first time in 1899 the railways showed a small profit of Rs. 11 lakhs. In successive years, the net receipts grew rapidly. After that, year after year (except in 1908 and 1921) there were net gains, which achieved a record of 15·85 crores of rupees in 1918. This was due to the general economic development of the country and, in particular, to the development of the Punjab and Sind irrigation systems. With the completion of the Chenab and Jhelum Canals, the unprofitable frontier railway, which was the Cinderella Railway in India, began to make a large profit for the State. Railway profits vary from year to year in India, because they depend upon monsoon conditions and upon the course of the internal and external trade of the country. The adoption of the recommendations of the Acworth Committee and the retrenchment carried out in response to the recommendations of the Inchcape Committee (1922-23) made the financial position of Indian railways sounder than before.

The railway system in India could not meet the requirements of the public between the years 1914 and 1921. Railway material could not be imported from England during this period and the existing lines even could not be maintained in good condition, nothing to say of the fresh extension. Maintenance and renewals fell seriously into arrears between 1914 and 1918 as shown in the following table, giving the percentage of expenditure on programme revenue works to gross earnings :²

Year	Per cent.
1913-14	6.1
1914-15	5.7
1915-16	4.6
1916-17	3.3
1917-18	2.1
1918-19	2.4

The expenditure was only postponed and had to be incurred later on. An ordinary commercial concern would have carried the money so underspent to reserve for replacements to be spent when the materials were again available. The independent railway companies did this; but the State railways did not. The unspent money was treated as part of the ordinary revenue of the Government in the year in which it was not spent, and the result was that the net profits of the State railways in the official returns were shown as having increased from 4.54 per cent. in 1914 to 7.07 per cent. in 1918-19. The apparent gain was not real and the result was that immediately after the War when the railway machinery was in urgent need of repair, funds were not forthcoming to put it right. The position was that maintenance was in arrears and the cost of materials of all kinds was above the pre-War level, and wages had also increased. The Aeworth Committee thus summarised the position: "There are scores of bridges with girders unfit to carry train loads up to modern requirements; there are many miles of rails, hundreds of engines, and thousands of wagons, whose rightful date for renewal is long overpast. Their cost has not been written off. They stand in the books at the original figure. The Government has formed no replacement reserve. It is not now physically possible within a short period of one or two years to replace all the plant of which the economic life is exhausted. If it were possible, it would be a burden upon current revenue too heavy to be borne without upsetting the normal railway finance. The position due to the unwise methods of the past must be redressed gradually. It will never be redressed under the present system of programmes and annual grants

² See Paragraph 70.

and lapses, but only when commercial accounting methods are introduced in the management of a commercial undertaking.”³ It was, therefore, not surprising that the public and the trading classes suffered a great inconvenience and loss. Public opinion was thus becoming very hostile to the management of State railways by guaranteed companies domiciled in England and demanded State management.

The Indian Railway Committee presided over by a railway expert from England, the late Sir William Acworth, was appointed in November 1920. The appointment of the Committee was the outcome of discussions originating in the question of the action to be taken in connection with the East Indian Railway, a State-owned railway managed by the East Indian Railway Company, whose contract was terminable in December 1919. The contract was extended to 1924; and the general questions arising out of the discussion of the case were referred to the Acworth Committee. The terms of reference of the Committee were:—

“(1) To consider, as regards railways owned by the State, the relative advantages, financial and administrative, in the special circumstances of India, of the following methods of management:—

- (a) direct state management;
- (b) management through a company domiciled in England and with a Board sitting in London;
- (c) management through a Company domiciled in India and with a Board sitting in India;
- (d) management through a combination of (b) and (c); and advise as to the policy to be adopted as and when the existing contracts with the several railway companies can be terminated.

“(2) To examine the functions, status and constitution of the Railway Board and the system of control exercised by the Government of India over the railway administration, and to recommend such modifications, if any, as are necessary for the adequate disposal of the railway business of the Government.

“(3) To consider arrangements for the financing of railways in India, and in particular the feasibility of the greater utilisation of private enterprise and capital in the construction of new lines.

“(4) To report whether the present system of control by Government of rates and fares and the machinery for deciding disputes between railways and traders are satisfactory, and, if not, to advise what modifications are desirable.

³ See Paragraph 68.

“(5) To make recommendations that may seem germane to the enquiry.”

The Committee issued their Report in 1921 and its recommendations fall into the following categories: those relating to (a) finance and financial control; (b) the constitution, functions and status of the controlling authority; (c) relations between railways and their customers; (d) management and finance; and (e) miscellaneous questions.

SEPARATION OF THE RAILWAY FINANCE FROM THE GENERAL FINANCE

The question of the separation of the railway finance from the general finances of India was discussed in 1899 during the Viceroyalty of Lord Curzon. Both Colonel Gardiner, then in charge of the Public Works Department, and Lord Curzon advocated the separation of the railway from the Imperial finance, because the existing system was faulty and fatal to railway development. The Secretary of State, however, expressed the opinion that, as long as the railways depended on Government for money, they must share in the vicissitudes of the public finances. The question was again raised in 1906, by Sir John Hewett, then the Commerce Member of Council, who advocated separation. The Acworth Committee in 1921 recommended the same course, and the question was further examined by the Railway Finance Committee; but it was decided to postpone a definite decision. The question was again examined in connection with the recommendation of the Retrenchment Committee in 1923, that the Indian railways should be so worked as to yield an average return of at least $5\frac{1}{2}$ per cent. on the capital at charge and it was decided that the separation should be carried out, and the Separation Convention was arrived at. Before discussing the main features of the Separation Convention, we may examine the recommendations of the Acworth Committee in this connection. They recommended the separation of the railway finance from the general finances on various grounds. Firstly, in the past the Government failed to provide the railways with adequate funds for capital and expenditure on development and extensions, and even for the essential operations of renewals and repairs. The Mackay Committee had recommended that the Government should fix periodically a standard of annual capital expenditure amounting to Rs. 18.75 crores and that it was desirable to adopt a steady annual rate of expenditure which might be reasonably maintained even in times of difficulty. The Government did neither adopt “the modest standard recommended by the Committee,” nor adhered over a series of years to any uniform rates as shown by the following table :—

Year	Capital programme Rs. Crores
1908-09	15.00
1909-10	15.00
1910-11	16.30
1911-12	14.25
1912-13	13.50
1913-14	18.00
1914-15	18.00
1915-16	12.00
1916-17	4.50
1917-18	5.40
1918-19	6.30
1919-20	26.55
1920-21	21.98
1921-22	17.82

The outbreak of the War must necessarily have led to a stoppage of railway development, but the failure to carry into effect either of the recommendations of the Mackay Committee is obvious from the figures prior to 1915-16.

Secondly, the system of allotments then prevailing was very adversely criticised by the Committee. The effect of inadequate allotments would have been bad in any case; but it is worse when "the allotment is suddenly cut down during the currency of the year to which it relates, and works in progress are suspended, staff are disbanded at a moment's notice, and materials are left lying on the ground for an indefinite period. An almost equally bad effect is produced when later on in the year, the general financial position having unexpectedly improved, the Finance Member with equal suddenness lifts his hand and thus encourages the railways to spend more freely. For then, in fear of the guillotine of 'lapse' which must descend on 31st March, in eager haste the railway officials start to spend, with inadequate staff and hurriedly collected materials, the money unexpectedly thrust upon them."⁴ As a practical effect of the policy, the Committee referred to the completion of the Itarsi-Nagpur Railway, 238 miles in length, which took about 17 years to be completed from the date of construction. Out of the estimated total cost of the line of Rs. 4 $\frac{3}{4}$ crores, Rs. 1 $\frac{1}{2}$ crores was expected to be the interest charge on the capital which lay idle, while the line was still under construction.

The Committee then described the system of programmes according to which the allotments were made to the different railways. Each Agent submitted to the Railway Board the *July Forecast*, a statement relating to Programme Capital

⁴ See Paragraph 36.

Expenditure and to Programme Revenue Expenditure. It was a provisional combination of the two programmes, setting out the amount desired by the Agent to be allotted to him for expenditure on renewals, betterments, additions and extensions during the year commencing on the following 1st April. The statement specified separately all works costing more than Rs. 2,50,000.

The programme included figures for three years and the system of forecasting for three years ahead was introduced in 1904. The second and third year forecasts began to be ignored by the Railway Board and treated as negligible by both sides. In the *July Forecast* the Agent kept down his demand "not only by his feeling that it is useless to ask for the unattainable, but also by his knowledge that, in default of a settled programme of uninterrupted construction resting on secure finance, his power of spending is restricted to that with which his existing engineering organisation can cope."

The programme then was discussed with the Railway Board and the latter would arrive at a preliminary agreement with each Agent regarding the sums which might be allotted to him for expenditure in the ensuing financial year on Capital Account and Revenue Programme Account. The former includes the whole cost of new works and that part of the cost of replacements which represent betterments and additions; while the latter includes so much of the cost of such works of renewals and replacements as is chargeable to revenue, but excludes all revenue expenditure of the nature of wages, current working expenses and ordinary day-to-day repairs.

The Railway Board after reducing them would add them up and place the consolidated statement before the Finance Department to ascertain the amount likely to be supplied by the Finance Member. On hearing from the Finance Department, the *Forecasts* were re-examined by the Railway Board and about the month of August each Agent was instructed to revise his programmes on the new basis.

A consolidated triennial railway programme of capital expenditure was compiled by the Railway Board at this stage and submitted to the Secretary of State for approval in November. After receiving the Secretary of State's cabled approval, the Railway Board would communicate to each Railway Agent the provisional grant of the preceding December. On receipt of the final allotment each railway would draw up the final issue of the Budget estimate, showing in detail each work individually costing over Rs. 25,000, and the same would be submitted to the Railway Board in the following month. The Committee summarised the whole position in Paragraph 54 of their Report as below :—

"Apart from the successive stages of discussion and estimating already indicated, there are frequent revisions and

reviews of the figures and estimates, which are necessitated mainly by the inclusion of the railway figures in the general budget of the country. The grants intimated to the railways at the end of March, that is, just before the commencement of the year to which they relate, are far from being final except in name. Changes are frequent throughout the year; they are sometimes necessitated by developments in the railway position which lead to increased demands which could not have been foreseen, or to surrenders of funds which for one reason or another it has proved impracticable to spend advantageously within the period covered by the grant. But they are also occasioned by considerations of a quite extraneous nature; grants may be cut down during the year because the Finance Department has to meet increased demands from other departments, or they may be increased unexpectedly at a late stage in the year because of some unforeseen windfall."

The system of lapse was also criticised by the Committee though it was approved by the Mackay Committee. That portion of the grant which could not be spent in the year concerned lapsed and the result was that the railway Agent would try to get the work done hurriedly, and works in progress might remain unfinished; because there was no certainty that enough money would be available in the next year.

The result was that immediately after the War the Government were compelled to pay as high as 7 per cent. for money which before the War could have been had at about 4 per cent.; because it was not possible to postpone the expenditure further. According to the Committee, the economic development of India suffered heavily because of the utter failure even to keep abreast of the day-to-day requirements of the traffic actually in sight and clamouring to be carried. If the Government had borrowed money even at a rate considerably higher than the rate of net return that could be earned by the railways on the amount, the action of Government according to the Committee would have been justified.

The Committee, therefore, did not think that the Indian railways could be modernised and improved to be able to advance the economic development of the country without radical reforms in the methods of finance. It was, therefore, recommended that the Railway Budget should be separated from the General Budget of the country and reconstructed in a form which frees a great commercial business from a system which assumes that the concern goes out of business on each 31st of March and recommences on the 1st of April, and that the railway management should be emancipated from the control of the Finance Department.

The Committee recommended that railways should have a separate Budget of their own and assume the responsibilities

for earning and spending their own income. The first charge on that income after meeting their working expenses should be interest on the debt incurred by the State for railway purposes.

THE SEPARATION CONVENTION

On 20th September 1924 the Assembly adopted a Resolution regarding the separation of Railway from General Finances. The Resolution is given below :—

“This Assembly recommends to the Governor-General in Council that in order to relieve the general budget from the violent fluctuations caused by the incorporation therein of the railway estimates and to enable railways to carry out a continuous railway policy based on the necessity of making a definite return to general revenues on the money expended by the State on railways :—

(1) The railway finances shall be separated from the general finances of the country and the general revenues shall receive a definite annual contribution from railways which shall be the first charge on the net receipts of railways.

(2) The contribution shall be based on the capital at charge and working result of commercial lines, and shall be a sum equal to one per cent. on the capital at charge of commercial lines (excluding capital contributed by Companies and Indian States) at the end of the penultimate financial year *plus* one-fifth of any surplus profits remaining after payment of this fixed return, subject to the condition that, if in any year railway revenues are insufficient to provide the percentage of one per cent. on the capital at charge, surplus profits in the next or subsequent years will not be deemed to have accrued for purposes of division until such deficiency has been made good.

The interest on the capital at charge of, and the loss in working, strategic lines shall be borne by general revenues and shall consequently be deducted from the contribution so calculated in order to arrive at the net amount payable from railway to general revenues each year.

(3) Any surplus remaining after this payment to general revenues shall be transferred to a railway reserve; provided that if the amount available for transfer to the railway reserve exceeds in any year three crores of rupees only two-third of the excess over three crores shall be transferred to the railway reserve and the remaining one-third shall accrue to general revenues.

(4) The railway reserve shall be used to secure the payment of the annual contribution to general revenues; to provide, if necessary, for arrears of depreciation and for writing down and writing off capital; and to strengthen the financial position of railways in order that the services rendered to the public may be improved and rates may be reduced.

(5) The railway administration shall be entitled, subject to such conditions as may be prescribed by the Government of India, to borrow temporarily from the capital or from the reserves for the purpose of meeting expenditure for which there is no provision or insufficient provision in the revenue budget subject to the obligation to make repayment of such borrowings out of the revenue budgets of subsequent years.

(6) A Standing Finance Committee for Railways shall be constituted consisting of one nominated official member of the Legislative Assembly who should be chairman and eleven members elected by the Legislative Assembly from their body. The members of the Standing Finance Committee for Railways shall be *ex officio* members of the Central Advisory Council, which shall consist, in addition, of not more than one further nominated official member, six non-official members selected from a panel of eight selected by the Council of State from their body and six non-official members selected from a panel of eight elected by the Legislative Assembly from their body.

The Railway Department shall place the estimate of railway expenditure before the Standing Finance Committee for Railways on some date prior to the date for the discussion of the demand for grants for railways and shall, as far as possible, instead of the expenditure programme revenue show the expenditure under a depreciation fund created as per the new rules for charge to capital and revenue.

(7) The railway budget shall be presented to the Legislative Assembly if possible in advance of the general budget and separate days shall be allotted for its discussion, and the Member-in-charge of Railways shall then make a general statement on railway accounts and working. The expenditure proposed in the railway budget, including expenditure from the depreciation fund and the railway reserve, shall be placed before the Legislative Assembly in the form of demands for grants. The form the budget shall take after separation, the details it shall give and the number of demands for grants into which the total vote shall be divided shall be considered by the Railway Board in consultation with the proposed Standing Finance Committee for Railways with a view to the introduction of improvements in time for the next budget, if possible.

(8) These arrangements shall be subject to periodic revision but shall be provisionally tried for at least three years.

(9) In view of the fact that the Assembly adheres to the resolution passed in February 1923, in favour of State management of Indian railways, these arrangements shall hold good only so long as the East Indian Railway and the Great Indian Peninsula Railway and existing State-managed railways remain under State management. But, if in spite of the Assembly's resolution above referred to, Government should enter on any

negotiations for the transfer of any of the above railways to Company management such negotiations shall not be concluded until facilities have been given for a discussion of the whole matter in the Assembly. If any contract for the transfer of any of the above railways to Company management is concluded against the advice of the Assembly, the Assembly will be at liberty to terminate the arrangements in this Resolution.

Apart from the above Convention this Assembly further recommends—

- “(I) that the railway services should be rapidly Indianised, and further that Indians should be appointed as Members of the Railway Board as early as possible, and
- (II) that the purchases of stores for the State Railways should be undertaken through the organisation of the Stores Purchase Department of the Government of India.”

THE ACTUAL CONTRIBUTION

The question is whether the railway system of a country is to be run in the national interests without regard to the cost of the service and the return on the outlay, or whether a fair return should be guaranteed by maintaining a certain level of rates and fares. The trend of opinion in recent years seems to be to achieve a fair return on capital or a standard revenue based on the conception of such a fair return. If the railways are owned by the State, should the gain be utilised for railway development or go to reduce the rate of fair return, or should it go to reduce taxation? The Convention of 1924 was of the nature of a compromise which divided up the net gain and allowed a portion to be utilised to reduce taxation and another in building up railway reserves.

The following table shows the contributions to General Revenues :—

Year	Crores of Rupees
1924-25	6.78
1925-26	5.49
1926-27	6.01
1927-28	6.28
1928-29	5.23
1929-30	6.12
1930-31	5.74
1931-32	5.36*
1932-33	5.23*
1933-34 (Revised)	5.21*
1934-35	5.04*

* These contributions were due but held in abeyance owing to the net railway earnings being insufficient.

The following table shows the position of the Depreciation Fund :—

Year	Rupees in Crores	
	Credit to Fund	Debit to Fund
1924-25	10.35	7.39
1925-26	10.67	7.98
1926-27	10.89	8.05
1927-28	11.38	10.95
1928-29	12.00	9.60
1929-30	12.59	11.76
1930-31	13.07	11.40
1931-32*	13.46	8.26
1932-33*	13.77	6.35
1933-34*	13.50	8.00
1934-35	13.71	8.66

* The loans from the fund during these three years were 4.25, 10.23 and 7.93 crores of rupees respectively.

Previous to 1924, Indian railways did not set apart any sum annually to provide for the depreciation of assets that had not been corrected by the expenditure incurred in the year on repairs. During the War, this expenditure was restricted very much. The State railways consequently showed high profits; but their extra earnings were at the cost of the State and of the tax-payer. In the post-War years larger sums had to be provided annually for expenditure on renewals and replacements.

Hence a Depreciation Fund as provided for in the Convention of September 1924 was started. The original intention was to make it applicable to company-managed railways also. The companies would not accept the arrangement, and, therefore, the Government have been maintaining a separate account for company-managed railways. To this account is set apart an annual sum from the net earnings accruing to Government after giving the companies their surplus profits in accordance with the old practice.

Deficit budgets have now become a recurring feature of Indian railways as the following table will show :—

Year	Deficit in Crores of Rupees
1930-31	6.24
1931-32	9.86
1932-33	10.80
1933-34 (Revised)	7.93
1934-35	5.06
1935-36 (Revised)	4.54
1936-37 (Estimates)	3.44

The strategic railways are to a great extent responsible for this deficit as shown by the following table :—

Year	Crores of Rupees
1934-35	1.95
1935-36	1.85
1936-37	2.00

Prior to 1930-31 there were surplus budgets beginning with the year 1899, the deficits being only in 1908 of about Rs. 2 crores and in 1921 of slightly over Rs. 9 crores. These recent deficits have been met by loans from the Depreciation Fund, which, at the end of 1936-37, will stand at a low figure of about Rs. 12 crores.

STATE Vs. COMPANY MANAGEMENT

In theory the case against State management of railways may be strong ; but simple appeal to theory is of little avail when we come to the case of a particular country. In actual practice, historical causes rather than theoretical considerations have determined any particular system in operation and different countries are pursuing different systems. Government take up railway business for various reasons. They may be political, or the State may like to make up for the lack of private enterprise, or the object may be to provide cheaper rates, better facilities and more impartial treatment of the various classes and interests.

All these reasons have been powerful in India in strengthening the case for State management ; while company management in the real sense of the word is not possible in this country, and, therefore, as the Majority Report of the Acworth Committee point out "the whole reference to foreign countries is in our opinion irrelevant. It may be that State ownership in the countries mentioned is a mistake. We have, however, not to advise about the past policy of other countries, but about a future policy for India under the conditions that we find here to-day. Conditions in India being what they are, we have failed to find any solution of the problem submitted to us consistent with the retention of company management. We therefore do not hesitate...to recommend that in India the State should manage directly the railways which it already owns." (Para 233.)

In India the State has acquired or retained the ownership of all the lines, and also direct State management to some extent, as in the case of the North-Western Railway and Eastern Bengal Railway. Recently the East Indian Railway (1924), the Great Indian Peninsular Railway (1925) and the Burma Railways (1929) have also come under state management. Most of the State-owned railways were managed by

companies with a London domicile at the time when the Acworth Committee issued their recommendations.

The Acworth Committee were evenly divided on the alternative of State management *Vs.* management by Indian domiciled companies. They, however, unanimously ruled out the management of Indian railways by London domiciled companies and they also rejected a system of management by a combination of English and Indian domiciled companies. The management by London domiciled companies was rejected on the following grounds :—

Firstly, the guaranteed companies were not owners of the undertakings which they managed. By taking the illustration of the East Indian Railway Company, the Committee proved that the interests of the shareholders were infinitesimal. When the old East Indian contract terminated, the Company was purchased by the State for £ 3,27,50,000, and payment of this price was made in the form of terminable annuities amounting to £ 14,73,750 annually. Under the new contract, shareholders representing £ 65,50,000 or one-fifth share of the purchase price agreed to postpone their annuity and accepted a new contract in place of it. These deferred annuitants or quasi-shareholders constituted the East Indian Railway Company. The management was entrusted to them and the Secretary of State guaranteed 4 per cent. interest on their capital, *plus* a certain share of the surplus profits.⁵ Under the contract of 1880, the Company was entitled to one-fifth of this profit and to one-fifteenth under the contract of 1900 ; whereas later on, this share came to one-hundredth.

Further, the capital of the deferred annuitants represented actual cash handed over and invested for the capital purposes of the undertaking ; but the share of the Secretary of State on which his proportion of the surplus income was based, did not represent the actual cash but the capitalised good-will also. Thus the share of the Company in the surplus profits was reduced to a vanishing point.

Thus the company managing the railway did not remain, in the ordinary sense of the word, a railway company at all. It did not own anything and was not joint owner even to an infinitesimal extent. The East Indian Railway belonged lock, stock and barrel to the Government of India, and on the termination of the contract, the Company would merely expire in case of the refusal by the Secretary of State to renew the contract. Possessing no assets, it would not require to be

⁵ Surplus profits refer to gross receipts remaining after meeting working expenses, annuity, sinking fund payments, and interest on loan capital whether in the form of debentures and debenture stock of the company or of loans or advances by the Secretary of State.

wound up, and the quasi-shareholders would revert to the position of the ordinary annuitants.

The debenture holder of a guaranteed company occupied an equally unusual position. Normally a debenture holder has a charge on the undertaking to which he lends money; but the debenture holder of an Indian railway has no such charge. The Secretary of State holds the money in his own name and the company have no power to touch it without his consent. He frequently applies that money to expenditure on another railway; and that, even on the undertaking of the issuing company, the money can only be spent when and to such an extent as permitted by the Secretary of State and on works approved by him.

The Committee, therefore, pointed out that through no fault of their own the part played by the guaranteed companies in financing the railways had been quite unimportant. And to allow the English domiciled companies to increase their share capital in the undertakings managed by them would meet with strong opposition from the public. They did not, therefore, recommend that course and suggested the transfer of administrative and financial control of railways to India.

There were certain advantages of the London Boards to Indian railways. The railways could keep themselves in touch through them with British manufacturers, with British consulting engineers and with the London Stock Exchange. The directors had technical and administrative knowledge of the railways, and their familiarity with Indian conditions with a view to initiate and elaborate new schemes for the improvement and development of Indian railways could be of great use. But there were the disadvantages of absentee control and it was difficult for the London Boards to keep themselves in touch with modern social and trade conditions of India and therefore the management of Indian railways by the Boards of London domicile was rejected by the Committee.

Five members of the Committee including the Chairman made further observations on the subject of the English companies in view of its bearing on the question of State *vs.* Company management in India.⁶ The case for State management of Indian railways may be summarised as below :—

It is true that a company, investing its own money and managing its own property, and judging its officials by their success in making profits, usually conducts its business with more enterprise, economy and flexibility than are found by experience to be attained in business managed directly by the State; but the English companies ceased long ago to be

⁶ See Paragraphs 210-239 of the *Acworth Committee Report on Indian Railways*.

of contracts. An Indian company would be a new creation, operating under a new contract. The bulk of the capital of the new companies will have to be subscribed by Government and privately subscribed capital will be small. Even if gradually, private capital were to increase, the company's investment would be very small for a long time. Why should the Government, possessing a majority interest hand over the management to the minority. Further, the shareholders in the ordinary company would not risk their money without a Government guarantee. This scheme might secure some money; but it would not secure money in sufficient quantity to relieve the Government of the necessity of borrowing freely in its own name. And even if it did, the objections would be that the public would pay dearly for the money.

In summing up the case for State management the Committee concluded "that no scheme for the establishment of Indian domiciled railway companies is acceptable. Only if relieved from risk of loss will shareholders subscribe at all. Even when so relieved, they will only subscribe relatively small amounts. Such small amounts would not justify entrusting them with substantially independent management. And unless management is substantially independent the justification for the existence of a company disappears. And, therefore, approaching the question, not as one of national sentiment, but purely from the practical point of view, we find ourselves in agreement with the almost unanimous opinion of Indian witnesses, and recommend that the undertakings of guaranteed companies.....be entrusted to the direct management of the State."

The majority met the objections of the minority against State management of Indian railways. The first point of the minority is that Government cannot be wholly relied upon to provide the necessary funds. That the Government has not provided sufficient money in the past is true, but why it should not be able to do so in the future is not easily understandable. If a borrower fails to get the money because he refuses to pay the market price for it, there is no reason why he should not get the money on being prepared to pay the necessary price. The Commonwealth and State Governments of Australia with a much smaller population have been able to borrow practically double the sums which India has borrowed, even though a much larger proportion than in the case of India is non-revenue earning.

It has been claimed that the improvements effected in the administration of State railways are due to the emulation inspired by company management. But in fact in India there is no reason to believe that company management is more efficient or more enterprising than State management.

There has been as much zeal and readiness to adopt improvements on State railways as on the company lines.

The Minority preferred company management because of the experience of other countries. The reply is two-fold : that in India company management in the ordinary sense does not exist and cannot be brought into existence, and secondly, isolated details are valueless. The whole reference to foreign countries is out of place and irrelevant. State ownership in some foreign countries may be a mistake ; but the question is not about the past policy of other countries, but about a future policy for India under the existing conditions.

The Minority suggested that company management would better secure the appointment and promotion of Indians in railway administration ; but the Indian public opinion take the opposite view according to the evidence tendered before the Acworth Committee.

The advocates of company management point out that under their scheme Indian money would be raised so freely that there would be less need than in the past to have recourse to the English market. The reply is that the total amount of money raised by the proposed new companies would be so small a proportion of the whole amount needed that it would not appreciably affect the ratio in which the necessary funds would have to be raised as between the two countries. To hand over the management to Indian companies would be to close the London Money Market against them. The Indian railways, because of the variety of shares of small amounts, are out of favour in the English market. It is clear that the further increase in the number of different securities and the transfer of the domicile of the companies from England to India would not increase the popularity of Indian railway investments.

The management by companies of Indian domicile would be an experiment ; but State management is not an experiment as it has long existed in India. Even, however, if it were a question of choice between two experiments, and assuming either experiment to be a failure, it would be easier to transfer a State-managed railway to a private company than to disestablish on, say, six or twelve months' notice, an already established company. The machinery for testing the State experiment is in existence, while that for the company experiment would require to be specially created.

Under State management, the convenience of traders and passengers would be much better attended to than under company management. The companies have been charged with making the maximum amount of profits as their sole object, and there is a great dissatisfaction in India on account of their alleged neglect of the interests of the passengers,

traders and industrialists. The grievances of the public have a much greater chance of being redressed speedily and effectively under State management. It has been pointed out that company management does not encourage the development of indigenous industries by sufficiently favourable treatment; that it gives preferential treatment to import and export goods; that under the present system of company management large profits are made in British interests; and that the companies have not pursued the policy of employing Indians in higher appointments to an adequate extent and adequate facilities have not been granted them for technical training. These disadvantages are expected to disappear under State management.

Indian commercial and political opinion is united in the demand for State management. In 1922-23 the question was referred to certain local governments and public bodies and opinions were collected and discussed. The approaching termination of the contract of the East Indian Railway on 31st December 1924 and of that of the Great Indian Peninsular Railway on 30th June 1925 required an early decision. When the question was debated in the Legislative Assembly in February 1923, the non-official Indian members were unanimously for State management. The Government of India proposed that while accepting the necessity for taking over the management of the East Indian and the Great Indian Peninsular Railways by the State, the door should be left open for handing over one or both of these railways to an indigenous company to secure the benefit of company management. The Indian non-official members were decidedly in favour of State management, and the motion for taking these two railways under State management was passed. They were accordingly taken over by the Government for direct management. The Burma Railways also passed under State management from January 1929. The contracts of the other companies expire at different dates, the last being in 1950, when the contract of the Bengal-Nagpur Railway will expire. In 1930 the Southern Punjab Railway was purchased by the North Western Railway, and the financial result of the purchase which cost approximately Rs. 703 lakhs is estimated to be a gain to Government of about Rs. 47 lakhs a year.

RAILWAY RATES POLICY

According to orthodox economic theory a railway is economically advantageous to the community only if it pays its way in the long run. No gain comes from carrying a thing from one place to another unless it is produced at the first place so cheaply that it can bear the cost of carriage to the second. The test of the utility of the carriage is its ability

to stand the transportation charge. The other view is that a railway or other means of transportation may bring advantages to the community even though it is not earning any profit to the owners. It is thus argued that a government may run a railway even at a loss, because the people as a whole gain something that offsets that loss. A new country or region may be opened with advantage by railways which do not pay at the outset. This case resembles that of protection to young industries; but eventually the railway must pay its way. If the losses of the early stage are not recouped, they are definite losses. Thus where subsidies are given to encourage railway construction, they should be in the nature of loans, to be reimbursed when profits begin.

The case is different from that of industries which yield utilities more directly. In some industries financial loss is consistent with public gain. A municipal water-supply may involve a deficit; but it brings a real advantage to the public. An adequate water-supply brings hygienic gains and direct utilities to the people, which cannot be measured by the price people are willing to pay. The post office may be administered on non-commercial principles; because it spreads knowledge and increases the intelligence of the people, a boon which cannot be measured by its market value. Passenger traffic too presents a somewhat different case from goods traffic. The managing of passenger traffic on non-commercial principles removes congestion and promotes the mobility of labour. Cheap fares under congested conditions may bring a real social gain, which cannot be measured by what the individuals are willing to pay. Even goods traffic may not pay its way at the outset. Industrialisation may be very necessary and if railways do not pay their way from the outset, but encourage the growth of industries which promote the economic development of the country, there is a net advantage. But ultimately they must pay their way.

With regard to railway rates in India, it may be said that there has been a long-standing grievance that they have been based entirely on grounds of monetary advantage to the railways and that they have been manipulated to help European merchants, regardless of their effects on the native industries of India. This complaint was voiced in the Legislative Assembly at Delhi by Sir Ibrahim Rahimtulla and by others before the Industrial and Fiscal Commissions and the Indian Railway Committee of 1920-21. One of the specific charges is that low exceptional rates exist for traffic to and from ports, especially the great ports of Calcutta and Bombay at the expense of internal traffic. This encourages the exports of raw materials and the imports of foreign manufactures.⁷

⁷ See *Indian Fiscal Commission Report*, Para 127.

The system of block rates has also been responsible for the existence of discontent among Indian traders and businessmen. It leads to an artificial diversion of traffic inconvenient to trade and industry. A block rate is a high rate quoted to retain traffic on the line on which it originates and to prevent or block it from passing off, after only a short lead, on to a rival route. A typical case arose in 1908 when a steamer concern was started between Broach and Bombay. The Bombay, Baroda and Central India Railway Company found that a certain amount of traffic was being diverted. They applied to the Railway Board that they should be permitted to impose on the through traffic for the short distance to or from Broach rates sufficiently high to leave little or nothing for the steamer portion of the journey. In the case of sugar, the Company's power of charge was increased four-fold. The Broach steamers withdrew from the competition; and it was on the intervention of the Bombay Government that the exceptional increases in the railway rates were withdrawn.⁸

An incidental effect of the railway rates policy in the past has been the congestion of industries in the port towns, which is responsible for many of their existing difficulties. The serious labour difficulties are in a certain measure due to the concentration of the industries in centres situated far away from the interior. The determination of the railway rates is no doubt a very complex matter. It is governed by the principle of charging what the traffic will bear and is affected by a number of considerations. The Government have always exercised some control over the fixing of railway rates by laying down the minima and maxima and by framing a general classification of goods. The railways themselves have given certain concessions to Indian industries, such as the low freight charges on a few raw materials, as much in their own interests as in those of the industries concerned. In 1915 the Railway Board issued a circular urging upon the railways the expediency of a favourable treatment for Indian industries. The Indian Fiscal Commission admitted that the complaints regarding the unfair treatment meted out to Indian industries were not without foundation. The Industrial Commission recommended that railway rates on goods moved to and from the ports should be so framed as to encourage the use of raw materials into finished goods in India before export; and they also recommended that consignments travelling over more than one line should be charged a single sum based on the total distance. The Fiscal Commission held that special rates should be granted for a term of years to new industries and even to others if they could make out a case for special

⁸ See *Acworth Committee Report*, Paragraphs 153, 154.

treatment. The Agricultural Commission recommended the grant of concession rates on the transport of fertilisers, fuel, fodder, etc.; and they suggested a re-examination of rates on raw material required for agricultural machinery and implements and also on their transport. Some of these recommendations were accepted by the Government of India.

The Acworth Committee recommended the establishment of a Rates Tribunal to adjudicate disputes between the railways and the public in relation to rates and fares fixed by the railways. A similar Tribunal known as Rates Advisory Committee was set up in England under the English Ministry of Transport Act, 1919, and the Indian Railway Committee were evidently influenced by the constitution of that body. Hence they recommended the establishment of a Rates Tribunal, consisting of an experienced lawyer as chairman and two other members, one representing the commercial interests and the other representing the railways, with power to add two additional members on each side. In April 1926 a Rates Advisory Committee was set up to investigate and make recommendations to Government on subjects relating to complaints of undue preference, complaints regarding unreasonable rates, complaints or disputes in respect of terminals, complaints in respect of conditions as to packing attached to a rate and complaints that railways do not fulfil their obligations to provide reasonable facilities for trade.

There is little room for an increase in the scale of rates and fares, and to battle successfully with road competition, the short distance rates both for passenger and goods traffic need reduction, with a simultaneous abolition of differences in class, both for passengers and goods, as in the case of motor bus and railway luggage rates. Other possible improvements are the abolition or reduction of terminals, and of short distance charges now levied on short distance traffic, the introduction of a general scheme of mileage gradation on the continuous mileage on all railways intended to increase the average length of haul, and the extension of the "free" time for wharfage and demurrage.

In April 1934 a special Committee of the Indian Railway Conference Association was appointed to revise the general classification of goods in India. They were asked to report what statistics should be compiled to furnish the data required in solving the problems which changes of the general classification on the lines suggested in the previous paragraph would present. The Committee were asked to keep in view the fact that the statistics to be suggested by them should enable the financial effects of any changes in classification or rating policy to be estimated.

The Acworth Committee also recommended the establishment of Central and Local Advisory Councils to give the Indian public a voice in railway management. All State railways now possess such Committees; while there is also a Committee of the Central Legislature, consisting of representatives from the Assembly and the Council of State.

OVER-CAPITALISATION, INTEREST CHARGES, ETC.

The Indian railways have been incurring deficits for the last many years and the Railway Member in presenting the Budget for 1936-37 pointed out that trade depression, nationalistic policies of the various countries including India, rail-road competition, ticketless travelling and undercharging of freight were the causes responsible for this state of affairs. Cost on account of labour legislation and improvements in the service conditions of the staff were also stressed as the causes responsible for deficits.

Trade depression is undoubtedly responsible for this state of affairs; but recovery on this account cannot be made till there is a rise in prices, a process which must take time. The pursuance of nationalistic policies has led to the realignment of traffic along new routes, leading to the substitution of short-lead for long-lead traffic. This adjustment also will take time. The case of rail-road competition is discussed separately. Strictness towards ticketless travellers may remove overcrowding of third class compartments, but it is not likely to improve railway earnings to any appreciable extent; while there might be slight improvement in revenue by removing frauds regarding the undercharging of freight.

The internal organisation of railways requires improvement. The question of over-capitalisation should be investigated into with a view to improve the condition of railway finances in this country. Over-capitalisation may mean excessive capital or watered capital. The latter is really fictitious capital and should not be confused with the former. In all probability when railways were purchased from private companies from time to time by the Government of India, amounts were paid for premises 25 per cent. more than their capital value.

The steady growth of interest charges has been responsible for the diminution of the net return from Indian railways. The method of calculating interest on railway capital is somewhat peculiar. It is calculated at the fixed rate of 3.3252 per cent. on the total outlay as on the 31st March 1917, and at an average rate of interest on all capital outlay after that date. The average rate of interest has varied as given below :—

1919-20	..	..	5.9328 per cent.
1920-21	..	..	5.1979 "
1921-22	..	..	5.1038 "
1922-23	..	..	5.48 "
1923-24	..	..	5.69 "
1924-25	..	..	5.54 "
1925-26	..	..	5.66 "
1926-27	..	..	5.43 "
1927-28	..	..	5.38 "
1928-29	..	..	5.63 "
1929-30	..	..	5.31 "

Previously it was the practice to obtain the average rate of interest applicable in any year by dividing the total interest charges for all railways, actually payable on all loans floated by the Government of India after 1916-17 by the nominal amount of the debt outstanding. This method did not allow for loans floated at a premium or discount. Most of these loans were floated at a discount, and therefore the actual rate of interest applied has been naturally less than the actual cost of borrowing. The method was altered and the rate is now obtained by dividing the total interest charges, not by the nominal amount of the outstanding debt but by the actual amount realised for the nominal amounts. This has meant an increase of approximately one-third of one per cent. in the rate and about a crore in the interest charges borne by railway revenues.

In order to improve the financial condition of the railways in this country, an enquiry is necessary into such questions as over-capitalisation, interest charges, etc. The enquiry must be independent and should consist of the representatives of the legislature, trade, industry, commerce and economists.

RAILWAY AND MOTOR-BUS COMPETITION

The effect of motor competition on railway earnings should not be underestimated. Indian railways have recognised this fact and are trying to adjust themselves to the changing circumstances. They are coming to terms with road traffic. The first Rail-Road Conference was held at Simla in 1931 and model vehicle rules suitable for application throughout the country were drafted. In 1932 Messrs. Mitchell and Kirkness were appointed by the Government of India to enquire into and make a report on road and railway competition and the possibilities of their co-ordination and organic development. The Road-Rail Conference which met in Simla in April 1933, considered the problems on the basis of the material collected by the experts. The following resolutions were accepted at the Conference :—

“In areas where uneconomic competition between railway and road transport has been proved to exist, such increased co-operation and co-ordination may necessitate the adoption, by mutual agreement, of measures designed to reduce such uneconomic competition to the minimum compatible with the maintenance of healthy competition.

“Any comprehensive or uniform plan of general development must sooner or later involve a gradual expansion of facilities for rural motor transport, complementary to the railways and to other arterial roadways, but as internal district communications—apart from the main arteries—are largely controlled by local bodies, any intra-provincial co-ordination of effort must necessarily in the first instance be a matter for the local government and legislatures, who, in such matters, should consult, and to the best of their ability, co-operate with the railway and other interests concerned.

“In order to ensure increased co-operation and more intelligent co-ordination of effort between the various authorities concerned, the Conference considered that the following measures would be justifiable:—

(a) The control of public service and goods motor transport should be regulated in the interest of public safety and convenience.

(b) The number of vehicles licensed to ply for hire should be restricted so as to prevent such competition between all forms of transport as may be contrary to the public interest.

“This Conference considers that the statutory provisions which at present limit the operation of motor service by certain railways should be repealed.

“This Conference recommends that the present regulations regarding public service and goods motor transport should be reviewed with the object of amending them so as to afford every encouragement to the development of rural services even to the extent in exceptional cases of granting of monopolies for limited periods.

“This Conference considers that, in the interests of all concerned, a co-ordinated plan should be drawn up for the taxation of motor transport by the various authorities.

“This Conference considers that—

(a) the present road development account should be continued for the duration of the present constitution and would urge that provision for its continuance be made in the new constitution;

(b) the class of roads to which the road development account should be applied including the maintenance of roads constructed from that account, be reconsidered;

(c) in present circumstances the most urgent need is an improvement in the efficiency, and a reduction in the cost, of

the transport of agricultural produce to markets and thence to the railways ; future road development programmes should be framed accordingly."

In many provinces, Boards of Communications have been set up where representatives of railways meet local authorities and discuss road problems. They aim at seeing that fresh roads do not run on parallel lines to the railways. With a proper co-ordination and development of motor-bus service, roads can prove good feeders to railways.

RAILWAYS UNDER THE NEW CONSTITUTION

Sections 181 to 199 of the Government of India Act, 1935, lay down provisions subject to which Indian railways will be financed and controlled. The executive authority of the Federation in respect of the regulation and construction, maintenance and operation of railways shall be exercised by a Railway Authority. Out of the seven members of the Authority not less than three, including the President, shall be appointed by the Governor-General *in his discretion*. The Authority shall act on business principles and will pay due attention to the interests of agriculture, industry, commerce and the general public. On questions of policy, it shall be guided by instructions of the Federal Government and as to whether a question is or is not a question of policy, the decision of the Governor-General *in his discretion* shall be final.

The Authority shall maintain a Railway Fund and all moneys received on revenue or capital account to discharge their functions shall be paid into that fund, which will be utilised to meet expenditure for carrying on such functions. The Authority can also maintain separate provident funds for the benefit of railway employees.

The receipts of the Authority on revenue account in any financial year shall be applied in—

- (a) defraying working expenses ;
- (b) meeting payments due under agreements to railway undertakings ;
- (c) paying pensions and contributions to provident funds ;
- (d) making due provision for maintenance, renewals, improvements and depreciation ;
- (e) making interest payments to the revenues of the Federation ; and
- (f) defraying other expenses properly chargeable against revenue in the year.

Any surpluses on revenue account shall be apportioned between the Federation and the Authority in accordance with a scheme to be prepared by the Federal Government. Or until such a scheme has been prepared, the distribution will be in accordance with the existing principles. The amounts

of the receipts and expenditure shall be audited by the Auditor-General of India. The Authority shall publish annually a report of their operations during the previous year and a statement of accounts in an approved form.

The Governor-General may appoint a Railway Rates Committee to advise the authority on disputes between the Authority and the public in connection with rates or trade facilities. A Bill for regulating railway rates or fares shall not be introduced in either chamber of the Federal Legislature except on the recommendation of the Governor-General.

There are provisions for requiring the Federated States and the Railway Authority to afford all reasonable facilities for through traffic at through rates and for preventing unfair discrimination. There shall be a Railway Tribunal, consisting of a President, who will be one of the judges of the Federal Court, and two other persons, to whom the Federated States will be able to make appeals from certain directions of the Railway Authority. The Tribunal will have the power to alter the orders of the Railway Authority and to issue orders for the payment of compensation and of costs.

CHAPTER XXI

Local Finance

IN the early days of government, national and local finance could not be distinguished from one another. The political units were so small and the range of their activities so localised that the administration was necessarily on a restricted scale. The functions and undertakings of some of the largest nations of ancient times would be overshadowed by those of ordinary municipalities of modern times. But as population grew and the smaller nations were gradually absorbed by the larger ones, the need for a division between central and local functions became imperative. Up to that time, in comparatively small territories, the people had been in close contact with the governing body, and there was thus no necessity of an intermediate authority. But direct relations became more difficult with the growth of the nation in population and extent. The state found itself burdened with an ever-growing number of duties ; while the central government could not possibly take an efficient interest in localised affairs in every part of the kingdom. Even with the best of intentions to administer directly for local needs, the government would have found itself handicapped by the lack of knowledge of the peculiar circumstances of each unit. Thus the need for devolution of functions and responsibilities became imperative as the nation grew in population and extent.)

This fact necessitated the subdivision of functions between the State and the smaller authorities and this took place in a very haphazard manner. This subdivision of functions did not develop on identical lines in various countries and, therefore, there could be no uniformity in the apportionment of tasks and in the raising and allocation of revenues. The differences were mainly caused by historical and geographical conditions. The powers and functions which were originally devised for meeting immediate needs with little regard to wider issues, gradually acquired some degree of permanence. The central authority in different countries came to have a far from uniform control over the local bodies. The British Parliament has, for instance, legal rights to abolish the present division into counties and parishes ; but the United States Government has no such powers. There the individual states have certain inalienable rights ; because they existed as political bodies before the formation of central government. Thus they were given privileges in the national constitution which the British local bodies or even the Indian provinces do not possess.

Thus, local finance plays a larger part in the United States than in Great Britain on account of the size of the administrative

unit and on account of the relative weakness of central control. The individual states have adopted methods of raising revenue which are beyond the powers of British local authorities. They rely on the general property tax for about half their income and have very wide powers in the matter of assessment. Some of the states also have income-tax. In fact direct taxation is one of the characteristic features of local finance in America as contrasted with the methods in Great Britain. In British finance, a much more important place is occupied by the system of grants-in-aid from the Central Exchequer to local authorities than in American finance.

(In some European countries, *e.g.*, France, Italy and Spain in particular, municipalities still depend on octrois, *i.e.*, local import and export duties, for the bulk of their revenue.) It used to be a feature of the English local finance also under the guild era of industry ; but the practice has long since ceased in that country. Octroi taxation has little economic justification, and its persistence in some places is due to people's inertia and to the long-established tax-raising machinery to which the citizens have become accustomed.

The lack of a uniform practice in the methods of raising finance for local bodies is due to the absence of universally accepted division of functions between the central and the local government. (In some countries the rights of local bodies are very prescribed, and they have to obtain permission for almost every important undertaking from the national authority ; while in other countries, they possess a considerable degree of autonomy.)

Sometimes the interests of the country as a whole require that the central authority must provide certain services. There is also a strong case for central control where uniformity of policy and co-ordination of activities are essential ; but many functions can best be carried out by local authorities. Where the needs and conditions of a particular district require special knowledge and provision, or when the service is of an exceptional kind, the nature of which depends upon the special circumstances of the locality, the people on the spot are best able to deal with the situation.) In some cases, the duties may require constant and detailed supervision, when local responsibility will give the best results.

The central government is the proper authority for organising the national defence, and (even when the local authorities have a considerable degree of autonomy, the right to engage in dealings with foreign governments and to provide for the military and naval forces is an exclusive right of the central authority. In the interests of unity and economy, the postal system should be under the charge of a central body ; while the right of issuing coinage, the scheme of weights and

measures, and similar other agencies which facilitate national trade, must be in the charge of a central authority)

(Certain functions, *e.g.*, water-supply, lighting, sanitation, police protection, education, etc., cannot be adequately or economically carried out by the State.) It does not, however, mean that the State has no right to intervene even when these functions may be inefficiently performed by the local authority ; but what it means is that the State should not interfere in such cases except when the local authority is incompetent. According to J. S. Mill, "It would not be a matter personally indifferent to the rest of the country if any part of it became a nest of robbers or a focus of demoralisation, owing to the maladministration of the police ; or if, through the bad regulations of its goal, the punishment which the Courts of Justice intended to inflict on the criminals confined therein (who might have come from, or committed their offence in, any other district) might be doubled in intensity, or lowered to practical immunity."¹

The organisation of defence is essentially a national duty ; while the administration of the High Courts of Justice is also in the hands of the State. The police forces can also be included in the same category, and the State makes substantial grants to local authorities towards the upkeep of the police, but many people would urge the transference of full responsibility to the central authority. The same mode of reasoning could be applied to several other functions administered largely by local authorities. "If the water-supplies or the sanitary arrangements of a district are below the standard considered necessary for the maintenance of full health, the rest of the country cannot look on with equanimity. Epidemics know no municipal or county barriers. Also, the benefits of such services as education cannot be confined to the areas in which the instruction is given. Some financial assistance and central control is essential if the national minimum standard is to be maintained."²

(It is mainly for historical reasons that destitution is still dealt with to a large extent on a local basis. The Elizabethan legislation substituted a compulsory for a voluntary system ; while it defined the practice by which the administration of relief was left to the officials of the parish.) The Law of Settlement of 1662 reaffirmed this policy. According to this legislation destitute settlers in a parish could be removed to their original parish within forty days of their leaving the latter place. There was some justification for treating poverty in this narrow fashion originally ; because the country was not then an economic unit and destitution could be attributed to local causes. But the roots of unemployment and poverty

¹ *Representative Government.*

² H. A. Silverman, *Taxation, Its Incidence and Effects*, p. 277.

became more and more widespread with an expansion in business, industries and commerce with the advancement of the industrial and commercial revolutions of the 19th century. Causes and conditions in one place now have great repercussions on conditions in other localities. A change in national habits might cause serious damage to a localised industry; and now very often the reason for poverty and unemployment is to be attributed to international rather than to national rearrangements and factors. Very little of the poverty can now be assigned to local causes, yet the public in Great Britain continues to emphasise local responsibility.

(There is no fundamental difference between national and local taxation. The principles governing the revenues of London, Paris or Bombay are not less important than those guiding the finances of the minor nations.) The significance of the term "local" is relative. According to Professor Cannan, "the real difficulty is not to find a local tax which is not a rate, but to find any tax which is not local. A New York State tax is local in relation to the United States, and..... a true imperialist would regard similar imposts which we call 'imperial taxes' as local."³ But when we compare a local authority with the nation of which the local authority in question forms a part, we find differences of considerable significance in their finances. *Firstly*, there is the difference of degree, *i.e.*, the national finances are far greater in magnitude than local finances. *Secondly*, there is the distinction between the uniformity of national taxes and the variability of local ones. The latter vary from one locality to another; while the former are more or less uniform. *Thirdly*, there is a difference in the manner of assessment. National taxes are uniform, but they are drawn from several sources; while local taxes, though variable, are all governed by the single criterion of immovable property.)

Another distinction of a different kind arises from the difference in emphasis laid upon the element of benefit in public finance. In the first place, (national taxes are on a very huge scale, and it is, therefore, difficult if not impossible, to link up actual payment and benefit. The cost of certain services as defence against external aggression cannot be split up according to the advantage conferred upon individuals. Moreover, even if the connection could be traced, the extent to which it could serve as a basis of taxation must of necessity be limited.) "It would be foolish to suggest that for the benefits provided in the form of old-age pensions, grants to the insurance funds, and so on, a specific tax should be levied upon the recipients."

³ *History of Local Rates*, p. 4, 2nd Edition.

On the other hand, the element of benefit is more pronounced in the case of local finance. The area is more restricted and it is, therefore, more possible for the ratepayers to identify particular payments with particular benefits. Of course, some services are as difficult to assign on a basis of individual contributions as are the services of a central authority. For example, the expenditure of a municipal or a District Board on education and road construction does not give a calculable return to the tax-payer in exact proportion to the amount that he is required to pay. Most of the citizens may get no direct advantage at all; while others may receive considerably more than they give. (The rich people may not participate directly in the educational facilities; while the poor may derive a considerable benefit therefrom.)

There are certain services which are provided on a definite cost basis. This is the case with tramways, gas, electricity and other forms of municipal enterprise, which are conducted more or less on commercial lines. Only that part of their revenue which represents a profit should be regarded as a local tax in the real sense. Some municipalities in Western countries have contemplated extending the practice of supplying milk at less than actual cost to the poorer classes of the community. The immediate loss would be more than compensated by the improved physique of the children and their greater efficiency when they become earners or producers.

There are other public services which yield a handsome profit and thus they provide a relief to ratepayers. There is a difference of opinion with regard to the propriety of charging such prices as will yield a large surplus for this purpose. No serious objection should be taken to the making of profits on services like public markets and parking grounds; and local criticism is usually absent when most of the profit is made from visitors to the town. But it may be said that taking the country as a whole, (the whole of the local profit is made out of the more common public services, and comes from the people who live or who carry on their business on the spot.) (The practice of appropriating the profits of certain public undertakings for the relief of the rates is open to criticism on grounds of equity.) Much of this profit comes from services used by people of the working classes. They live in small houses and, therefore, they get little relief in rates. The relief goes to the people of the more prosperous classes, who very rarely use these services and who enjoy a relief to their rates out of all proportion to the use they make of the service that yields the surplus. It is, therefore, necessary that the charges for such services should not be higher than necessary to cover the actual cost, and the absence of a profit should not be taken to imply an inefficient administration. In some

cases, these services may have to be supplied at a charge lower than the actual cost, because that would increase the efficiency of the poor who would become more efficient earners and thus the burden of social costs would be lighter.

LOCAL FINANCE IN INDIA

About 90 per cent. of the population of British India lives in villages and thus a far greater importance attaches to District Boards than to Municipalities. At one time Provincial Rates or surcharges on land were an important item in the budget of the Central Government. (To-day they are a substantial part in the revenues of District and Local Boards and their proportion to total income varied in 1922-23 from 25 per cent. in Bombay to 63 per cent. in Bihar and Orissa. They started in Bombay and Madras in the sixties of the last century and were levied chiefly on land for the construction and repairing of roads and for other types of expenditure of a social and educational nature as the upkeep of schools, dispensaries, village sanitation, etc. In pursuance of Lord Mayo's scheme of financial decentralisation, the principle was extended to other provinces. In 1871, Acts were passed levying similar cesses in Bengal, the Punjab and the United Provinces. In some places, cesses for roads and schools, assessed at the time of land revenue settlement, were continued side by side with the new general cess. Between 1871 and 1905 certain cesses were introduced for Imperial purposes. The Famine Insurance Fund was instituted in 1878 to which certain cesses were added in some provinces chiefly for the payment of village officers.

There was an improvement in the financial position of the Government of India and in 1905-06 all cesses except for local purposes were abolished. The effect was a transfer of the fund for local purposes and the Provincial Government was compensated from the Imperial Treasury. (Recently there has been a tendency either to increase the general rate or to add new cesses for certain local purposes as primary education. The basis of these local cesses on land varies with the land revenue system. In some rayatwari areas, the cess is levied on the basis of land revenue; whereas in the United Provinces and the Punjab the annual value is taken at twice the land revenue as the basis. In the permanently settled areas the basis is either the rental value or the acreage. The rates of the cesses are left to the discretion of the local bodies; but the maxima and the minima are laid down by the Provincial Legislature. The land cesses are collected with land revenue; but they are administered by the local bodies. The limits vary from $6\frac{1}{2}$ per cent. to $12\frac{1}{2}$ per cent. According to the Report of Sir Walter Layton, the maximum which

in some provinces has been one anna in the rupee should not be retained ; because the land revenue no longer represents a high proportion of the net produce, particularly in the permanently settled areas and because all the other cesses on land have been abolished.⁴ The land cess is levied at a flat rate and is not, therefore, in proportion to ability to pay. It is, however, an appropriate tax, because it is applied for local benefit. The Taxation Enquiry Committee recommended the standardisation of land revenue so as to leave a wider margin for local taxation.

Local bodies in India are under Provincial Governments, and their functions, constitution and resources are regulated according to the provisions of the statutes by which they have been created. The Presidency Corporations of Calcutta, Bombay and Madras have separate Acts ; while there are Municipal and District Boards Acts in other provinces, according to which local bodies are constituted. They are controlled by the Local Self-Government Department of the Provincial Government, which delegates some powers to the Commissioners and District Officers. The Government of India also controls local bodies by prescribing the taxes which the latter can impose and by limiting their borrowing powers. In recent years the passage of legislation in different provinces has tended to widen the scope and powers of local bodies by which their contributions have been made more liberal, and certain irksome financial restrictions have been removed. As this process develops in course of time, conditions for the success of local bodies will become more propitious.

Their financial year begins on April 1, and the annual estimates are prepared by the Chairman or by the Executive Officer of the Board, who gets the necessary information from the heads of the departments. The estimates are ready about eight weeks before the expiry of the current year, and are submitted to the Board after being examined by the Finance Sub-Committee, in case there is one in existence under the Board. As a general rule, the Board can pass the estimates ; but in some cases the previous sanction of the Commissioner of the Division is necessary. In such cases, the estimates are forwarded to those officers who can insist on the omission or insertion of certain items. The Board then passes them finally on their return from such officers. Generally speaking, the Board can dispose of the estimates, and a copy of the sanctioned estimates has to be sent to the local Government through the District Officer for their information.

The Provincial Government has to satisfy itself that the obligatory functions of the Board have been duly provided

⁴ *Simon Commission Report*, para 275.

for in the estimates. The Board is authorised to revise the budget in the course of the year, make supplementary provisions and authorise reappropriations of savings from one head to another; but the balances cannot be reduced below the minimum laid down by the Provincial Government. In case, the budget estimates require the approval of the Government Officer for passing them, all proposals for supplementary provisions also require the approval of such authority. It may be said that most of the local bodies have final powers to pass their budgets and the control of Government Officers is vanishing.

(Their functions are obligatory and optional, and the former have priority over the latter in the allocation of local funds, and local boards have to make provision for them within the limits of their resources. The local bodies obtain their income from certain prescribed sources and vary the rates of taxes and fees subject to certain maximum and minimum limits.) The Boards, which are indebted, have to obtain the sanction of Provincial Government to reduce their rates. Their receipts consist of income from taxes and fees, rents from markets, sale of night-soil, etc., and they also get grants-in-aid from provincial revenues. The permission to impose taxes is granted by Provincial Governments, and the local authorities make use only of those taxes which are suited to local conditions and are adequate for their local needs. They can also vary their rates without the previous sanction of the Local Government within certain limits. (The important sources of income of the urban boards are the taxes on houses and buildings, the octroi or its substitute, the terminal tax; while the main source of income of the Rural Boards is the land cess collected by the Provincial Governments and placed at the disposal of the District and Taluqa Boards.

Local bodies can apportion the benefits which the individuals derive from the services rendered by them with less difficulty than is the case with central authorities, and thus greater weight should be given to this consideration in obtaining revenues by local bodies. (Municipal trading should be more extensively utilised for raising funds. The grants-in-aid are given for general or for specific purposes, and they bear a certain proportion to the expenditure of local bodies. It is through them that the necessary amount of control and supervision can be enforced with real advantage and without a sacrifice of the initiative and freedom of local bodies; but in this country the grants-in-aid are only a means of supplementing the meagre resources of local bodies.)

(Local authorities should correlate benefit to services to an adequate extent, and their income should thus consist more of fees than of taxes.) This principle has still to be embodied

in the fiscal arrangements of local bodies in India ; but local taxation would be necessary even when this is done.

The procedure for the collection of taxes and other municipal dues is that the payer gets a bill from the local authority, and the payment is to be made in the office. A warning is issued if the payment is not made within a certain period of time, and legal action is taken against the defaulter, if the payment is not made even then. The system of outdoor collection is adopted in certain cases. The tolls, fees and octroi dues are collected by the tax-collector and paid into the municipal office. As already observed, the land cess, which is the main source of income of the rural boards, is collected by Provincial Governments. With certain exceptions, all local funds have to be deposited in the Treasuries or in the branches of the Imperial Bank. The expenditure is incurred according to the provisions of the budget estimates as finally passed or as modified later by local authorities. The estimates cannot be exceeded by the employees without obtaining the previous sanction of the Board. The claims for payment from the local revenues are presented to the chief Executive Officers, who pass them for payment after examining them. The payments are generally made by cheques on the balances in the Treasury or in the Imperial Bank. The establishment and other charges are paid on bills drawn on prescribed forms, which must be signed by the Executive Officers, and the amounts are drawn by cheques for disbursement.

The form of the accounts and the heads under which the receipts and expenditure are classified are prescribed by the Provincial Governments. The Report of the Auditor is considered at a meeting of the Board which decides the action to be taken on the points raised therein. Copies of resolutions embodying the decisions are sent to the auditor and to the officer, who receive the annual report of the Board. The objections, which are not withdrawn by the auditor, are settled either by the recovery of the accounts in question or are submitted for the orders of the Provincial Governments. The supervision of the latter in this respect is a safeguard against the misuse or mismanagement of local finances.

Local bodies can raise money by loans also ; which may be obtained from the Provincial Governments from the Provincial Loan Account, or raised in the open market. In the latter case, the sanction of the Government of India is necessary. Their loans have to be repaid in all cases, and the usual provision has to be made for repayment. The borrowing is allowed for meeting heavy outlays, which cannot be met out of annual revenues. It is done generally for public utility concerns of a non-remunerative character/ It is necessary to exercise a

check on the borrowing powers of local bodies to prevent them from sacrificing the interests of the coming generations of tax-payers. Their indebtedness is likely to increase as they gradually widen the sphere of their activities and take to trading enterprises, but that would not decrease the need for the control of Provincial Governments to prevent extravagance on the part of local bodies.

The total number of District and Taluqa Boards and Union Panchayats is 1,246. Their income from sundry taxes and rates in 1930-31 amounted to Rs. 16.57 crores ; while the corresponding figures for 1915-16, 1919-20 and 1927-28 were Rs. 7.50 crores, Rs. 9.8 crores and Rs. 15.56 crores respectively. Out of this meagre revenue, these bodies have to finance important rural needs like roads, schools, markets, public health and sanitation for a rural population amounting to 242 million. It is on financial grounds that Local Self-Government has not conferred any appreciable advantages to rural population so far.

The gross income of the Municipalities in British India in 1930-31 was nearly Rs. 36.60 crores ; whereas the corresponding figures for 1915-16, 1919-20 and 1927-28 respectively were Rs. 15.11 crores, Rs. 11.50 crores and Rs. 36.21 crores. The main sources of income consist of octroi, taxes on houses, lands and vehicles and tolls. There are about 781 municipalities in British India, with an aggregate population of over 21 million.

The following tables give the detailed financial position of District and Local Boards and Municipalities in British India :

(In lakhs of Rupees)

Income (excluding balances)				1915-16	1927-28
Provincial rates	..	..	..	3,39	4,84
Civil works	..	..	..	1,43	2,58
Other sources	..	..	..	2,68	8,14
TOTAL	..	..	..	7,50	15,56
Incidence per head	..	..	..	Rs. A. P. 0 5 1	Rs. A. P. 0 10 6

Expenditure				1915-16	1927-28
Education	..	..	..	1,82	5,72
Civil works	..	..	..	4,16	5,04
Sanitation, Hospital, etc.	..	..	..	70	1,94
Debt and miscellaneous	..	..	..	1,32	3,26
TOTAL	..	..	..	8,00	15,96

(In lakhs of Rupees)

Sources of Income	1915-16	1927-28	Heads of Expenditure	1915-16	1927-28
Municipal Rates and Taxes :—					
Octroi	1,45	1,41	General Administration and collection charges ..	76	1,59
Taxes on houses and lands ..	1,87	4,65			
Tax on animals and vehicles ..	21	42	Public Safety—		
Tax on professions and trades ..	18	13	Lighting ..	43	92
Tolls on roads and ferries ..	17	34	Police ..	9	17
Water-rate ..	97	1,87	Fire, etc. ..		
Lighting rate ..	15	18	Total ..	53	1,10
Conservancy rates ..	61	1,10			
Other taxes ..	19	1,68			
Total rates and taxes ..	5,80	11,96	Public Health and convenience Hospitals and Dispensaries and Vaccination ..	3,32	5,86
Realisation under special Acts ..			Plague charges, markets, gardens and sanitary ..	50	92
Grants from Government ..	11	17	Public Works ..	50	89
Rent of lands, houses, etc. ..	84	98	Public Instructions for Contributions for general purposes ..	1,42	2,40
Fees ..	23	45	Miscellaneous—	62	1,92
Receipts from markets and slaughter houses ..	38	79	Interest on loans ..	27	60
Other sources and miscellaneous ..	47	93	Other miscellaneous expenditure ..	77	1,68
TOTAL INCOME ..	8,67	17,00	TOTAL EXPENDITURE ..	43	1,46
<i>Extraordinary and Debt</i> ..	6,44	19,21			
GRAND TOTAL ..	15,11	36,21	<i>Extraordinary and Debt</i> ..	9,12	18,43
Incidence per head :	Rs. A. P.	Rs. A. P.		6,33	18,18
(i) Rates and Taxes ..	3 5 9	6 4 3	GRAND TOTAL ..	15,42	36,61
(ii) Total income, excluding Extraordinary and Debt ..	5 0 3	8 14 7			

The total annual income as given in the second table is distributed among 774 municipalities, and it is thus clear that on an average municipalities in India are financially very poor. The Bombay Corporation alone has an annual income of over Rs. 3 crores ; while the corresponding figure for the Calcutta Corporation is Rs. 2 crores. These corporations cannot stand comparison to municipalities in Western countries. Glasgow, for instance, with a population approximately equal to that of Calcutta, has about twelve times the income of the Calcutta Corporation.

Between 1914 and 1930, local expenditure in Japan increased from Rs. 41 crores to Rs. 229 crores ; whereas in India with five times the population of Japan, local expenditure in the same period increased from Rs. 26 crores to Rs. 54 crores only. Thus the *per capita* expenditure of local bodies for 1930 in India was Rs. 2 ; while the corresponding figure for Japan was Rs. 36 or eighteen times that of India. In India, the increase was 2.1 times ; while in Japan, it was 5.6 times.

In the United States of America, the expenditure of local bodies in 1927-28 amounted to Rs. 1,874 crores ; while the gross total expenditure of the Federal, State and Local Bodies put together for the same year amounted to Rs. 3,486 crores. This means that local bodies there have a spending power of about 54 per cent. of the total expenditure of the Federal, State and Local Governments ; while the local bodies in India spend only 20 per cent. of the corresponding total amount. For the year 1927-28, the *per capita* expenditure of the local bodies in the United States of America was over Rs. 150, or about 75 times the corresponding figure for India. The extraordinarily low expenditure of local bodies in India requires investigation.

The poverty of local bodies in India is thus in marked contrast with the rich resources of similar bodies elsewhere. The Simon Commission remarked that "local rates of all kinds, urban as well as rural, produced in 1927-28 in British India about £ 12½ millions, which is only little more than the income from rates in that year of the London County Council alone."⁵

The question of local finance came into prominence with the inauguration of the Reforms and the transfer of Local Self-Government to ministers. The resources of local bodies in India are very inadequate in view of the devolution of powers to local bodies and in view of the variety and wide range of their functions like public health, education, etc. They cannot introduce efficient standards of administration of the various functions assigned to them without a considerable increase in their monetary resources.

⁵ *Simon Commission Report*, Vol. I, para 377.

CAUSES OF INADEQUATE RESOURCES

The low taxable capacity of the people of this country is an important cause of the inadequacy of local resources in this country. The following table shows the national income and national wealth of a few countries which brings out the comparison clearly.

INCOME AND WEALTH

Country	Year	National Income		Year	National Wealth	
		Total Rs. (crores)	Per Head of population Rs.		Total Rs. (crores)	Per Head of Population Rs.
British India ..	1922-23	2,223	82	1930	12,000	441
The United Kingdom	1931	4,995	1,092	1925	29,432	6,371
The United States of America ..	1928	24,533	2,053	1928	1,12,315	9,365
Canada ..	1930	1,319	1,268	1929	8,344	8,023
France ..	1928	2,618	636	1928	18,857	4,581
Japan ..	1928	1,471	271	1924	13,645	2,038

The above figures vary with the production and prices from year to year, and also with the varying rates of exchange. Moreover, the figures are not for the same year. Thus the comparison can be regarded as approximate only. Making allowance for all these factors, the average income for British India in a normal year is about Rs. 82 per head ; while in the present slump, the average may be taken at about two-thirds of the normal, or Rs. 55 per head. The average income in Japan is Rs. 271 per head, in Germany Rs. 634, in France Rs. 636, in the United Kingdom Rs. 1,092, in Canada Rs. 1,268 and in the United States of America Rs. 2,053. Thus the income in the United States is more than 25 times that in India ; while that in the United Kingdom is nearly 13 times. The average *per capita* income in Japan is about $3\frac{1}{2}$ times the corresponding income in India.

The total wealth of the United States of America is estimated at Rs. 112,315 crores as against Rs. 12,000 crores for British India or about nine times, though the population of India is three times greater. The United Kingdom has property valued at Rs. 29,432 crores or about $2\frac{1}{2}$ times of that of India. The wealth of India as a whole may be estimated at about Rs. 15,500 crores and thus with 17 per cent. of the world's population, India has only 5 per cent. of the world's goods ; while America with only 7 per cent. of the world's population has about 40 per cent. of the world's wealth. These statistics

abundantly prove the low taxable capacity of India, which is responsible for the inadequacy of local as well as central and provincial resources.

Another important factor explaining the inadequacy of local resources is the unfair distribution of revenues between the central, provincial and local authorities. The bulk of the contribution from land in England goes to local bodies and the Central Government receives only a very small amount as land tax. The financial weakness of Indian local bodies is also explained by the fact that they have developed by the process of devolution of powers; while in other countries generally the development has been brought about by a process of a federation of strong, semi-independent smaller units into larger political units. In India the Central Authority has thus parted with smaller resources for local bodies. Further, the jurisdictions of local bodies in India are generally so extensive that they are removed from effective touch with tax-payers. But for this, the imposition of taxes on houses and persons in the villages by local bodies would have been easier. It would, therefore, be desirable to restore the influence of the village panchayats and to reduce their jurisdictions so as to bring them into effective touch with tax-payers. An increase in *per capita* income and wealth production by pursuing a definite programme of the economic development of the country must go a long way in improving the finances of local authorities and also of the Central and Provincial Governments.

IMPROVEMENT OF RESOURCES

The following recommendations were made by the Taxation Enquiry Committee to increase the resources of local bodies :—

(1) The land revenue should be standardised at a low rate to give better scope for local taxation.

(2) A share of the collection of provincial governments from ground rents in towns and from an increase in the rates on non-agricultural land should be transferred to local bodies.

(3) Municipalities should be empowered to tax advertisements.

(4) The scope of taxes on entertainment and betting should be extended, and local bodies should be given an adequate share of the proceeds.

(5) There should be an extension of, and improvement in, the administration of taxes on circumstances, property and professions.

(6) The import duty on motor cars should be reduced so that the provincial governments may be able to levy a provincial tax in place of tolls for distribution among local bodies.

(7) In selected areas local bodies should be empowered to levy a fee for the registration of marriages.

(8) The resources of local bodies should be supplemented by subsidies to be granted on services of national importance in such a way as to enable provincial governments effectively to enforce efficiency.⁶

The resources of local bodies can also be increased by extending the scope of municipal trading and enterprise. This would lessen the dependence of local bodies on tax revenue. Local taxes are comparatively inelastic and it is desirable to make use of other sources of revenue to a greater extent than is the case at present. In Western countries, particularly in Prussia, municipal enterprise is increasing and there are municipal tramways, waterworks, gas and electric concerns, bathing establishments, burial grounds, fisheries, docks, theatres, restaurants, mills, factories, dairies, etc. These enterprises are rendering effective service to the civic population and they are also providing a substantial source of revenue for municipalities.⁷ This aspect of local finance has so far been neglected in this country. Its possibilities should be explored to increase municipal and local resources and also to increase the amenities of life in towns and villages.

The following table gives the income and expenditure of District and Local Boards in India for 1930-31.⁸

Province	No. of Boards	Income Rs.	Incidence per head			Expenditure Rs.
			Rs.	A.	P.	
Madras ..	610	5,95,24,930	1	3	5	6,07,47,449
Bombay ..	249	2,32,71,826	1	3	6	2,35,16,561
Bengal ..	109	1,47,98,115	0	4	11	1,48,48,354
U. P. ..	48	1,93,72,249	0	6	8	1,99,93,994
Punjab ..	29	2,10,96,459	1	0	0	2,14,55,722
Bihar and Orissa ..	66	1,36,52,048	0	7	3	1,41,10,264
C. P. and Berar ..	108	82,63,338	0	6	2	82,22,505
Assam ..	19	36,04,257	0	7	3	37,93,045
N. W. F. P. ..	5	15,01,512	1	2	9	15,07,750
Ajmer-Merwara ..	1	2,29,263	0	6	7	2,37,072
Coorg ..	1	1,45,650	0	14	3	1,59,076
Delhi ..	1	2,45,295	1	4	4	2,49,953
TOTAL ..	1,246	16,57,04,942	0	10	5	16,88,41,735

⁶ *Taxation Enquiry Committee Report*, paras 194-196.

⁷ K. T. Shah and Bahadurji, *Functions and Finance of Indian Municipalities*, p. 434.

⁸ This and the following table have been compiled from the *Indian Year Book*, 1934-35, pp. 341 and 342.

The following table gives information regarding the income and expenditure of Municipalities in the chief provinces in India for 1930-31.

Province			Income Rs.	Expenditure Rs.
Presidency Towns				
Calcutta	..	..	4,64,73,418	4,25,15,073
Bombay City	..	..	16,63,24,539	16,59,91,737
Madras City	..	..	1,07,93,586	93,34,378
Rangoon	..	..	1,33,42,806	1,31,55,443
District Municipalities				
Bengal (excluding Calcutta)	..	..	94,99,331	96,75,593
Bihar and Orissa	..	..	52,32,982	44,66,171
Assam	..	..	13,16,719	13,55,257
Bombay (excluding Bombay City)	..	..	3,84,02,690	3,89,92,357
Madras (excluding Madras City)	..	..	2,09,31,578	2,18,01,802
U. P.	..	..	1,69,52,904	1,68,73,932
Punjab	..	..	1,36,69,870	1,40,15,220
N. W. F. P.	..	..	15,41,347	16,34,299
C. P. and Berar	..	..	81,64,733	87,15,730
Burma (excluding Rangoon)	..	..	78,28,061	80,84,408
British Baluchistan	..	..	7,61,600	7,58,473
Ajmer-Merwara	..	..	6,34,961	6,24,884
Coorg	..	..	48,919	51,212
Delhi	29,92,435	33,60,257
Bangalore	10,57,871	10,53,350
TOTAL			36,59,70,350	36,24,59,576

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